

CNB FINANCIAL CORP/PA  
Form 10-Q  
November 08, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018  
or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 000-13396  
CNB FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

Pennsylvania 25-1450605  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1 South Second Street  
P.O. Box 42  
Clearfield, Pennsylvania 16830

(Address of principal executive offices)  
Registrant's telephone number, including area code, (814) 765-9621

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of the issuer's common stock as of November 6, 2018

COMMON STOCK NO PAR VALUE PER SHARE: 15,247,411 SHARES



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FINANCIAL INFORMATION

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### Forward-Looking Statements

This quarterly report on form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, with respect to the financial condition, liquidity, results of operations, future performance and our business. These forward-looking statements are intended to be covered by the safe harbor for “forward-looking statements” provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are those that are not historical facts. Forward-looking statements include statements with respect to beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond our control). Forward-looking statements often include the words “believes,” “expects,” “anticipates,” “estimates,” “forecasts,” “intends,” “plans,” “targets,” “potentially,” “probably,” “projects” similar expressions or future conditional verbs such as “may,” “will,” “should,” “would” and “could.” Such known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from the statements, include, but are not limited to, (i) changes in general business, industry or economic conditions or competition; (ii) changes in any applicable law, rule, regulation, policy, guideline or practice governing or affecting financial holding companies and their subsidiaries or with respect to tax or accounting principles or otherwise; (iii) adverse changes or conditions in capital and financial markets; (iv) changes in interest rates; (v) higher than expected costs or other difficulties related to integration of combined or merged businesses; (vi) the inability to realize expected cost savings or achieve other anticipated benefits in connection with business combinations and other acquisitions; (vii) changes in the quality or composition of our loan and investment portfolios; (viii) adequacy of loan loss reserves; (ix) increased competition; (x) loss of certain key officers; (xi) continued relationships with major customers; (xii) deposit attrition; (xiii) rapidly changing technology; (xiv) unanticipated regulatory or judicial proceedings and liabilities and other costs; (xv) changes in the cost of funds, demand for loan products or demand for financial services; (xvi) other economic, competitive, governmental or technological factors affecting our operations, markets, products, services and prices; and (xvii) our success at managing the foregoing items. Some of these and other factors are discussed in our annual and quarterly reports filed with the Securities and Exchange Commission (“SEC”). Such factors could have an adverse impact on our financial position and our results of operations.

The forward-looking statements contained herein are based upon management’s beliefs and assumptions. Any forward-looking statement made herein speaks only as of the date on which it is made. Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

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## Part I Financial Information

## Item 1. Financial Statements

## CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except share data

|  | (unaudited)           |                      |
|--|-----------------------|----------------------|
|  | September 30,<br>2018 | December 31,<br>2017 |
| <b>ASSETS</b>  |                       |                      |
| Cash and due from banks  | \$ 34,637             | \$ 33,146            |
| Interest bearing deposits with other banks   | 1,863                 | 2,199                |
| Total cash and cash equivalents  | 36,500                | 35,345               |
| Securities available for sale  | 522,334               | 409,709              |
| Trading securities   | 8,887                 | 7,150                |
| Loans held for sale  | 775                   | 852                  |
| Loans  | 2,391,463             | 2,149,848            |
| Less: unearned discount  | (4,508)               | (3,889)              |
| Less: allowance for loan losses  | (22,510)              | (19,693)             |
| Net loans  | 2,364,445             | 2,126,266            |
| FHLB, other equity, and restricted equity interests  | 23,836                | 21,517               |
| Premises and equipment, net  | 49,301                | 50,715               |
| Bank owned life insurance  | 56,108                | 55,035               |
| Mortgage servicing rights  | 1,492                 | 1,387                |
| Goodwill   | 38,730                | 38,730               |
| Core deposit intangible  | 907                   | 1,625                |
| Accrued interest receivable and other assets   | 25,998                | 20,442               |
| Total Assets   | \$ 3,129,313          | \$ 2,768,773         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                       |                      |
| Non-interest bearing deposits  | \$ 345,154            | \$ 321,858           |
| Interest bearing deposits  | 2,177,225             | 1,845,957            |
| Total deposits   | 2,522,379             | 2,167,815            |
| Short-term borrowings  | 2,211                 | 34,416               |
| FHLB and other long term borrowings  | 250,211               | 222,943              |
| Subordinated debentures  | 70,620                | 70,620               |
| Accrued interest payable and other liabilities   | 29,516                | 29,069               |
| Total liabilities  | 2,874,937             | 2,524,863            |
| Common stock, \$0 par value; authorized 50,000,000 shares; issued 15,308,378 shares at<br>September 30, 2018 and December 31, 2017 | —                     | —                    |
| Additional paid in capital   | 97,328                | 97,042               |
| Retained earnings  | 165,427               | 148,298              |
| Treasury stock, at cost (22,948 shares at September 30, 2018 and 43,638 shares at<br>December 31, 2017)                            | (608)                 | (1,087)              |
| Accumulated other comprehensive loss   | (7,771)               | (343)                |
| Total shareholders' equity   | 254,376               | 243,910              |
| Total Liabilities and Shareholders' Equity   | \$ 3,129,313          | \$ 2,768,773         |

See Notes to Consolidated Financial Statements



## CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|  | Three months<br>ended September<br>30, |               |
|--|--|---------------|
|  | 2018                                   | 2017          |
| <b>INTEREST AND DIVIDEND INCOME:</b>   |  |               |
| Loans including fees   | \$30,385                               | \$25,215      |
| Securities:  |  |               |
| Taxable  | 2,698                                  | 1,970         |
| Tax-exempt   | 677                                    | 692           |
| Dividends  | 280                                    | 192           |
| Total interest and dividend income   | 34,040                                 | 28,069        |
| <b>INTEREST EXPENSE:</b>   |  |               |
| Deposits   | 4,812                                  | 2,345         |
| Borrowed funds   | 1,334                                  | 1,225         |
| Subordinated debentures (includes \$44 and \$71 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2018 and 2017, respectively)                          | 1,016                                  | 982           |
| Total interest expense   | 7,162                                  | 4,552         |
| <b>NET INTEREST INCOME</b>   | <b>26,878</b>                          | <b>23,517</b> |
| <b>PROVISION FOR LOAN LOSSES</b>   | <b>1,095</b>                           | <b>1,400</b>  |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>   | <b>25,783</b>                          | <b>22,117</b> |
| <b>NON-INTEREST INCOME:</b>  |  |               |
| Service charges on deposit accounts  | 1,584                                  | 1,244         |
| Other service charges and fees   | 732                                    | 587           |
| Wealth and asset management fees   | 1,031                                  | 952           |
| Net realized gains on available-for-sale securities (includes \$0 and \$5 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2018 and 2017, respectively) | —                                      | 5             |
| Net realized and unrealized gains on trading securities  | 421                                    | 160           |
| Mortgage banking   | 283                                    | 237           |
| Bank owned life insurance  | 335                                    | 592           |
| Card processing and interchange income   | 1,066                                  | 942           |
| Other  | 481                                    | 313           |
| Total non-interest income  | 5,933                                  | 5,032         |
| <b>NON-INTEREST EXPENSES:</b>  |  |               |
| Salaries and benefits  | 11,429                                 | 9,101         |
| Net occupancy expense  | 2,650                                  | 2,219         |
| Amortization of core deposit intangible  | 222                                    | 305           |
| Data processing  | 1,149                                  | 1,031         |
| State and local taxes  | 808                                    | 710           |
| Legal, professional, and examination fees  | 603                                    | 561           |
| Advertising  | 554                                    | 495           |
| FDIC insurance premiums  | 361                                    | 295           |
| Card processing and interchange expenses   | 767                                    | 541           |
| Other  | 2,251                                  | 2,360         |
| Total non-interest expenses  | 20,794                                 | 17,618        |

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|  |         |         |
|--|---------|---------|
| INCOME BEFORE INCOME TAXES   | 10,922  | 9,531   |
| INCOME TAX EXPENSE (includes \$(9) and \$(23) income tax expense from reclassification items in 2018 and 2017, respectively) | 1,686   | 2,285   |
| NET INCOME   | \$9,236 | \$7,246 |
| EARNINGS PER SHARE:  |         |         |
| Basic  | 0.60    | 0.47    |
| Diluted  | 0.60    | 0.47    |
| DIVIDENDS PER SHARE:   |         |         |
| Cash dividends per share   | \$0.170 | \$0.165 |

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

Dollars in thousands, except per share data

|  | Nine months<br>ended September<br>30, |          |
|--|---------------------------------------|----------|
|  | 2018                                  | 2017     |
| INTEREST AND DIVIDEND INCOME:  |                                       |          |
| Loans including fees   | \$85,817                              | \$71,100 |
| Securities:  |                                       |          |
| Taxable  | 6,862                                 | 6,286    |
| Tax-exempt   | 2,054                                 | 2,266    |
| Dividends  | 793                                   | 524      |
| Total interest and dividend income   | 95,526                                | 80,176   |
| INTEREST EXPENSE:  |                                       |          |
| Deposits   | 11,423                                | 6,709    |
| Borrowed funds   | 4,426                                 | 2,819    |
| Subordinated debentures (includes \$149 and \$220 accumulated other comprehensive income reclassification for change in fair value of interest rate swap agreements in 2018 and 2017, respectively)                            | 2,873                                 | 2,940    |
| Total interest expense   | 18,722                                | 12,468   |
| NET INTEREST INCOME  | 76,804                                | 67,708   |
| PROVISION FOR LOAN LOSSES  | 4,631                                 | 3,550    |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES  | 72,173                                | 64,158   |
| NON-INTEREST INCOME:   |                                       |          |
| Service charges on deposit accounts  | 4,102                                 | 3,499    |
| Other service charges and fees   | 2,073                                 | 1,675    |
| Wealth and asset management fees   | 3,151                                 | 2,775    |
| Net realized gains on available-for-sale securities (includes \$0 and \$1,543 accumulated other comprehensive income reclassifications for net realized gains on available-for-sale securities in 2018 and 2017, respectively) | —                                     | 1,543    |
| Net realized and unrealized gains on trading securities  | 672                                   | 475      |
| Mortgage banking   | 801                                   | 668      |
| Bank owned life insurance  | 1,074                                 | 1,308    |
| Card processing and interchange income   | 3,140                                 | 2,790    |
| Gain on sale of branch   | —                                     | 536      |
| Other  | 1,277                                 | 625      |
| Total non-interest income  | 16,290                                | 15,894   |
| NON-INTEREST EXPENSES:   |                                       |          |



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|  |          |          |
|--|----------|----------|
| Salaries and benefits  | 31,095   | 27,008   |
| Net occupancy expense  | 7,780    | 7,016    |
| Amortization of core deposit intangible  | 718      | 967      |
| Data processing  | 3,370    | 3,011    |
| State and local taxes  | 2,494    | 2,063    |
| Legal, professional, and examination fees  | 1,661    | 1,776    |
| Advertising  | 1,732    | 1,527    |
| FDIC insurance premiums  | 1,037    | 869      |
| Card processing and interchange expenses   | 2,139    | 1,577    |
| Other  | 7,310    | 6,635    |
| Total non-interest expenses  | 59,336   | 52,449   |
| INCOME BEFORE INCOME TAXES   | 29,127   | 27,603   |
| INCOME TAX EXPENSE (includes \$(31) and \$463 income tax expense from reclassification items in 2018 and 2017, respectively) | 4,353    | 7,194    |
| NET INCOME   | \$24,774 | \$20,409 |
| EARNINGS PER SHARE:  |          |          |
| Basic  | \$1.62   | \$1.34   |
| Diluted  | \$1.62   | \$1.34   |
| DIVIDENDS PER SHARE:   |          |          |
| Cash dividends per share   | \$0.500  | \$0.495  |

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

Dollars in thousands

|   | Three months<br>ended September<br>30, |         | Nine months ended<br>September 30, |          |
|---|--|---------|------------------------------------|----------|
|   | 2018                                   | 2017    | 2018                               | 2017     |
| NET INCOME  | \$9,236                                | \$7,246 | \$24,774                           | \$20,409 |
| Other comprehensive income (loss), net of tax:  |  |         |                                    |          |
| Net change in fair value of interest rate swap agreements designated as cash flow hedges:   |  |         |                                    |          |
| Unrealized gain (loss) on interest rate swaps, net of tax of \$0 for the three months ended September 30, 2018 and 2017, and (\$4) and \$1 for the nine months ended September 30, 2018 and 2017                                  | 1                                      | —       | 16                                 | (2 )     |
| Reclassification adjustment for losses recognized in earnings, net of tax of (\$9) and (\$25) for the three months ended September 30, 2018 and 2017, and (\$31) and (\$77) for the nine months ended September 30, 2018 and 2017 | 35                                     | 46      | 118                                | 143      |
|   | 36                                     | 46      | 134                                | 141      |
| Net change in unrealized gains on securities available for sale:  |  |         |                                    |          |
| Unrealized gains on other-than-temporarily impaired securities available for sale:  |  |         |                                    |          |
| Unrealized losses arising during the period, net of tax of \$0 for the three months ended September 30, 2018 and 2017, and \$0 and (\$47) for the nine months ended September 30, 2018 and 2017                                   | —                                      | —       | —                                  | 87       |
| Reclassification adjustment for realized gains included in net income, net of tax of \$0 for the three months ended September 30, 2018 and 2017, and \$0 and \$484 for the nine months ended September 30, 2018 and 2017          | —                                      | —       | —                                  | (899 )   |
|   | —                                      | —       | —                                  | (812 )   |
| Unrealized gains on other securities available for sale:  |  |         |                                    |          |
| Unrealized (losses) gains arising during the period, net of tax of \$653 and \$433 for the three months ended September 30, 2018 and 2017, and \$2,010 and (\$1,111) for the nine months ended September 30, 2018 and 2017        | (2,459 )                               | (814 )  | (7,562 )                           | 2,059    |
| Reclassification adjustment for realized gains included in net income, net of tax of \$0 and \$2 for the three months ended September 30, 2018 and 2017, and \$0 and \$56 for the nine months ended September 30, 2018 and 2017   | —                                      | (3 )    | —                                  | (104 )   |
|   | (2,459 )                               | (817 )  | (7,562 )                           | 1,955    |
| Other comprehensive income (loss)   | (2,423 )                               | (771 )  | (7,428 )                           | 1,284    |
| COMPREHENSIVE INCOME  | \$6,813                                | \$6,475 | \$17,346                           | \$21,693 |

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Dollars in thousands

|   | Nine months ended<br>September 30, |                  |
|---|------------------------------------|------------------|
|   | 2018                               | 2017             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                    |                  |
| Net income  | \$24,774                           | \$20,409         |
| Adjustments to reconcile net income to net cash provided by operations:   |                                    |                  |
| Provision for loan losses   | 4,631                              | 3,550            |
| Depreciation and amortization of premises and equipment, core deposit intangible, and mortgage servicing rights   | 3,661                              | 3,974            |
| Amortization and accretion of securities premiums and discounts, deferred loan fees and costs, net yield and credit mark on acquired loans, and unearned income | (472 )                             | (980 )           |
| Net realized gains on sales of available-for-sale securities  | —                                  | (1,543 )         |
| Net realized and unrealized gains on trading securities   | (672 )                             | (475 )           |
| Proceeds from sale of trading securities  | 434                                | 402              |
| Purchase of trading securities  | (1,499 )                           | (1,050 )         |
| Gain on sale of branch  | —                                  | (536 )           |
| Gain on sale of loans   | (510 )                             | (253 )           |
| Net gains on dispositions of premises and equipment and foreclosed assets   | (285 )                             | (64 )            |
| Proceeds from sale of loans   | 18,811                             | 17,978           |
| Origination of loans held for sale  | (18,404 )                          | (20,001 )        |
| Income on bank owned life insurance   | (1,074 )                           | (1,308 )         |
| Stock-based compensation expense  | 1,219                              | 600              |
| Changes in:   |                                    |                  |
| Accrued interest receivable and other assets  | (5,756 )                           | 2,829            |
| Accrued interest payable and other liabilities  | 2,627                              | (3,604 )         |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>  | <b>27,485</b>                      | <b>19,928</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                    |                  |
| Proceeds from maturities, prepayments and calls of available-for-sale securities  | 44,605                             | 59,347           |
| Proceeds from sales of available-for-sale securities  | —                                  | 15,374           |
| Purchase of available-for-sale securities   | (167,473)                          | (3,620 )         |
| Purchase of BOLI policies   | —                                  | (10,000 )        |
| Proceeds from death benefit of BOLI policies  | —                                  | 893              |
| Net cash received from sale of branch   | —                                  | 1,079            |
| Loan origination and payments, net  | (241,895)                          | (226,078)        |
| Purchase of FHLB, other equity, and restricted equity interests   | (2,319 )                           | (6,959 )         |
| Purchase of premises and equipment  | (1,373 )                           | (3,718 )         |
| Proceeds from the sale of premises and equipment and foreclosed assets  | 597                                | 563              |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(367,858)</b>                   | <b>(173,119)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                    |                  |
| Net change in:  |                                    |                  |
| Checking, money market and savings accounts   | 329,925                            | 35,303           |
| Certificates of deposit   | 24,639                             | 8,864            |
| Purchase of treasury stock  | (454 )                             | (1,360 )         |
| Cash dividends paid   | (7,645 )                           | (7,572 )         |
| Proceeds from stock offering, net of issuance costs   | —                                  | 19,294           |
| Repayment of long-term borrowings   | (22,732 )                          | (42,505 )        |

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|  |                |                |
|--|----------------|----------------|
| Proceeds from long-term borrowings   | 50,000         | 140,000        |
| Net change in short-term borrowings  | (32,205 )      | 7,659          |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                               | <b>341,528</b> | <b>159,683</b> |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                               | <b>1,155</b>   | <b>6,492</b>   |
| CASH AND CASH EQUIVALENTS, Beginning   | 35,345         | 29,183         |
| CASH AND CASH EQUIVALENTS, Ending  | \$36,500       | \$35,675       |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                       |                |                |
| Cash paid during the period for:   |                |                |
| Interest   | \$18,456       | \$12,699       |
| Income taxes   | \$4,250        | \$6,000        |
| <b>SUPPLEMENTAL NONCASH DISCLOSURES:</b>                                       |                |                |
| Transfers to other real estate owned   | \$228          | \$239          |
| Grant of restricted stock awards from treasury stock                           | \$933          | \$943          |
| Net assets transferred for sale of branch, excluding cash and cash equivalents | \$—            | \$543          |
| See Notes to Consolidated Financial Statements                                 |                |                |

CNB FINANCIAL CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the SEC and in compliance with accounting principles generally accepted in the United States of America (“GAAP”). Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

In the opinion of management of the registrant, the accompanying consolidated financial statements as of September 30, 2018 and for the three and nine month periods ended September 30, 2018 and 2017 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the periods presented. The financial performance reported for CNB Financial Corporation (the “Corporation”) for the three and nine month periods ended September 30, 2018 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Corporation’s Annual Report on Form 10-K for the period ended December 31, 2017 (the “2017 Form 10-K”). All dollar amounts are stated in thousands, except share and per share data and other amounts as indicated. Certain prior period amounts have been reclassified to conform to the current period presentation.

2. STOCK COMPENSATION

The Corporation has a stock incentive plan for key employees and independent directors. The stock incentive plan, which is administered by a committee of the Board of Directors, provides for aggregate grants of up to 500,000 shares of common stock in the form of non-qualified options or restricted stock. For key employees, the plan vesting is either one-third or one-fourth of the granted options or restricted stock per year, beginning one year after the grant date, with 100% vesting on the third or fourth anniversary of the grant date, respectively. Prior to 2018, for independent directors, the vesting schedule was one-third of the granted options or restricted stock per year beginning one year after the grant date, with 100% vested on the third anniversary of the grant date. Beginning in 2018, stock compensation received by independent directors vests immediately. At September 30, 2018, there was no unrecognized compensation cost related to nonvested stock options granted under this plan and no stock options were granted during the three and nine month periods ended September 30, 2018 and 2017.

In addition to the time-based restricted stock disclosed above, the Corporation’s Board of Directors grants performance-based restricted stock awards (“PBRsAs”) to key employees. The number of PBRsAs will depend on certain performance conditions and are also subject to service-based vesting. In 2018, awards with a maximum of 15,702 shares in aggregate were granted to key employees. In 2017, an award with a maximum of 10,000 shares was granted to a key employee.

Compensation expense for the restricted stock awards is recognized over the requisite service period noted above based on the fair value of the shares at the date of grant. Nonvested restricted stock awards are recorded as a reduction of additional paid-in-capital in shareholders’ equity until earned. Compensation expense resulting from these restricted stock awards was \$268 and \$1,219 for the three and nine months ended September 30, 2018, and \$204 and \$600 for the three and nine months ended September 30, 2017. As of September 30, 2018, there was \$1,042 of total unrecognized compensation cost related to unvested restricted stock awards.

A summary of changes in time-based nonvested restricted stock awards for the three months ended September 30, 2018 follows:

|                                  | Shares | Per Share<br>Weighted Average<br>Grant Date Fair<br>Value |
|----------------------------------|--------|---|
| Nonvested at beginning of period | 76,045 | \$ 23.09  |
| Vested                           | (250 ) | 18.58   |

Nonvested at end of period      75,795   \$   23.11

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A summary of changes in time-based nonvested restricted stock awards for the nine months ended September 30, 2018 follows:

|                                  | Shares   | Per Share<br>Weighted Average<br>Grant Date Fair<br>Value |
|----------------------------------|----------|---|
| Nonvested at beginning of period | 94,472   | \$ 20.79  |
| Granted                          | 22,108   | 26.92   |
| Forfeited                        | (130 )   | 26.29   |
| Vested                           | (40,655) | 19.66   |
| Nonvested at end of period       | 75,795   | \$ 23.11  |

The above tables exclude 15,600 shares that were granted and immediately vested. Compensation expense resulting from the immediately vested shares was \$0 and \$385 for the three and nine months ended September 30, 2018, and is included in the previously disclosed \$1,219 of stock-based compensation expense for the nine months ended September 30, 2018.

The fair value of shares vested was \$8 and \$1,479 during the three and nine months ended September 30, 2018, and \$6 and \$929 during the three and nine months ended September 30, 2017.

### 3. FAIR VALUE

#### Fair Value Measurement

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy has also been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following three levels of inputs are used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of most trading securities and securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Corporation's derivative instruments are interest rate swaps that are similar to those that trade in liquid markets. As such, significant fair value inputs can generally be verified and do not typically involve significant management judgments (Level 2 inputs).

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals prepared by third-parties. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also adjusts appraised values based on the length of time that has passed since the appraisal date and other factors. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.





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Assets and liabilities measured at fair value on a recurring basis are as follows at September 30, 2018 and December 31, 2017:

| Description                                | Total            | Fair Value Measurements at September 30, 2018 Using            |   |   |
|--|------------------|--|---|---|
|  |                  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>                             |                  |  |   |   |
| <b>Securities Available For Sale:</b>      |                  |  |   |   |
| U.S. Government sponsored entities         | \$145,509        | \$—  | \$ 145,509                              | \$ —                                      |
| States and political subdivisions          | 138,395          | —  | 138,395                                 | —   |
| Residential and multi-family mortgage      | 194,635          | —  | 194,635                                 | —   |
| Corporate notes and bonds                  | 12,036           | —  | 12,036                                  | —   |
| Pooled SBA                                 | 30,833           | —  | 30,833                                  | —   |
| Other                                      | 926              | 926  | —                                       | —   |
| <b>Total Securities Available For Sale</b> | <b>\$522,334</b> | <b>\$926</b>   | <b>\$ 521,408</b>                       | <b>\$ —</b>                               |
| Interest Rate swaps                        | \$191            | \$—  | \$ 191                                  | \$ —                                      |
| <b>Trading Securities:</b>                 |                  |  |   |   |
| Corporate equity securities                | \$6,643          | \$6,643  | —                                       | —   |
| Mutual funds                               | 1,687            | 1,687  | —                                       | —   |
| Certificates of deposit                    | 228              | 228  | —                                       | —   |
| Corporate notes and bonds                  | 278              | 278  | —                                       | —   |
| U.S. Government sponsored entities         | 51               | —  | 51                                      | —   |
| <b>Total Trading Securities</b>            | <b>\$8,887</b>   | <b>\$8,836</b>   | <b>\$ 51</b>                            | <b>\$ —</b>                               |
| <b>Liabilities,</b>                        |                  |  |   |   |
| Interest rate swaps                        | \$(182)          | \$—  | \$ (182)                                | \$ —                                      |

| Description                                | Total            | Fair Value Measurements at December 31, 2017 Using             |   |   |
|--|------------------|--|---|---|
|  |                  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>                             |                  |  |   |   |
| <b>Securities Available For Sale:</b>      |                  |  |   |   |
| U.S. Government sponsored entities         | \$108,148        | \$—  | \$ 108,148                              | \$ —                                      |
| States and political subdivisions          | 137,723          | —  | 137,723                                 | —   |
| Residential and multi-family mortgage      | 109,636          | —  | 109,636                                 | —   |
| Corporate notes and bonds                  | 17,200           | —  | 17,200                                  | —   |
| Pooled SBA                                 | 36,040           | —  | 36,040                                  | —   |
| Other                                      | 962              | 962  | —                                       | —   |
| <b>Total Securities Available For Sale</b> | <b>\$409,709</b> | <b>\$962</b>   | <b>\$ 408,747</b>                       | <b>\$ —</b>                               |
| Interest Rate swaps                        | \$149            | \$—  | \$ 149                                  | \$ —                                      |

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Trading Securities:

|                                    |         |         |         |        |
|------------------------------------|---------|---------|---------|--------|
| Corporate equity securities        | 5,125   | 5,125   | —       | —      |
| Mutual funds                       | 1,499   | 1,499   | —       | —      |
| Certificates of deposit            | 220     | 220     | —       | —      |
| Corporate notes and bonds          | 254     | 254     | —       | —      |
| U.S. Government sponsored entities | 52      | —       | 52      | —      |
| Total Trading Securities           | \$7,150 | \$7,098 | 52      | —      |
| Liabilities,                       |         |         |         |        |
| Interest rate swaps                | \$(310  | ) \$—   | \$ (310 | ) \$ — |

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The table below presents a reconciliation of the fair value of securities available for sale measured on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2018 and 2017:

|   | 2018 | 2017     |
|---|------|----------|
| Balance, January 1                                  | \$   | -\$2,049 |
| Total gains:  |      |          |
| Included in other comprehensive income (unrealized) | —    | 134      |
| Sale of available-for-sale securities               | —    | (2,183 ) |
| Balance, September 30                               | \$   | -\$—     |

The Corporation did not have any Level 3 securities during the three months ended September 30, 2018 and 2017.

Assets and liabilities measured at fair value on a non-recurring basis are as follows at September 30, 2018 and December 31, 2017:

| Description          | Total | Fair Value Measurements at September 30, 2018 Using            |   |
|----------------------|-------|--|---|
|                      |       | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Unobservable Inputs (Level 3) |
| Assets:              |       |  |   |
| Impaired loans:      |       |  |   |
| Commercial mortgages | \$324 | —  | \$ 324                                    |

| Description          | Total | Fair Value Measurements at December 31, 2017 Using             |   |
|----------------------|-------|--|---|
|                      |       | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Unobservable Inputs (Level 3) |
| Assets:              |       |  |   |
| Impaired loans:      |       |  |   |
| Commercial mortgages | \$11  | —  | \$ 11                                     |

Impaired loans, measured for impairment using the fair value of collateral for collateral dependent loans, had a recorded investment of \$1,310 with a valuation allowance of \$986 as of September 30, 2018, resulting in a provision (benefit) for loan losses of \$(634) and \$352 for the corresponding three and nine month periods ended September 30, 2018. Impaired loans had a recorded investment of \$646 with a valuation allowance of \$635 as of December 31, 2017. Impaired loans carried at fair value resulted in a negative provision for loan losses of \$(22) and \$(395) for the three and nine month periods ended September 30, 2017.

The estimated fair values of impaired collateral dependent loans such as commercial or residential mortgages are determined primarily through third-party appraisals. When a collateral dependent loan, such as a commercial or residential mortgage loan, becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values

are discounted to arrive at the estimated selling price of the collateral and a further reduction for estimated costs to sell the property is applied, which results in an amount that is considered to be the estimated fair value. If a loan becomes impaired and the appraisal of related loan collateral is outdated, management applies an appropriate adjustment factor based on its experience with current valuations of similar collateral in determining the loan's estimated fair value and resulting allowance for loan losses. Third-party appraisals are not customarily obtained in respect of unimpaired loans, unless in management's view changes in circumstances warrant obtaining an updated appraisal.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2018:

|                                       | Fair value | Valuation Technique   | Unobservable Inputs | Weighted Average (Range) |
|---------------------------------------|------------|---|---------------------|--------------------------|
| Impaired loans – commercial mortgages | \$324      | Valuation of third party appraisal on underlying collateral | Loss severity rates | 15% (10-15%)             |

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2017:

|                                       | Fair value | Valuation Technique   | Unobservable Inputs | Weighted Average (Range) |
|---------------------------------------|------------|---|---------------------|--------------------------|
| Impaired loans – commercial mortgages | \$ 11      | Valuation of third party appraisal on underlying collateral | Loss severity rates | 10% (10%)                |

Fair Value of Financial Instruments

The following table presents the carrying amount and fair value of financial instruments at September 30, 2018:

|                                     | Carrying Amount | Fair Value Measurement Using: |             |           | Total Fair Value |
|-------------------------------------|-----------------|-------------------------------|-------------|-----------|------------------|
|                                     |                 | Level 1                       | Level 2     | Level 3   |                  |
| <b>ASSETS</b>                       |                 |                               |             |           |                  |
| Cash and cash equivalents           | \$36,500        | \$36,500                      | \$—         | \$        | —\$36,500        |
| Securities available for sale       | 522,334         | 926                           | 521,408     | —         | 522,334          |
| Trading securities                  | 8,887           | 8,836                         | 51          | —         | 8,887            |
| Loans held for sale                 | 775             | —                             | 775         | —         | 775              |
| Net loans                           | 2,364,445       | —                             | —           | 2,334,576 | 2,334,576        |
| FHLB and other restricted interests | 16,885          | n/a                           | n/a         | n/a       | n/a              |
| Other equity interests              | 6,951           |                               |             |           | 6,951            |
| Interest rate swaps                 | 191             | —                             | 191         | —         | 191              |
| Accrued interest receivable         | 11,221          | 7                             | 3,748       | 7,466     | 11,221           |
| <b>LIABILITIES</b>                  |                 |                               |             |           |                  |
| Deposits                            | \$(2,522,379)   | \$(2,132,769)                 | \$(391,848) | \$        | —\$(2,524,617)   |
| FHLB and other borrowings           | (252,422 )      | —                             | (248,986 )  | —         | (248,986 )       |
| Subordinated debentures             | (70,620 )       | —                             | (68,202 )   | —         | (68,202 )        |
| Interest rate swaps                 | (182 )          | —                             | (182 )      | —         | (182 )           |
| Accrued interest payable            | (820 )          | —                             | (820 )      | —         | (820 )           |

The following table presents the carrying amount and fair value of financial instruments at December 31, 2017:

|                                     | Carrying Amount | Fair Value Measurement Using: |             |           | Total Fair Value |
|-------------------------------------|-----------------|-------------------------------|-------------|-----------|------------------|
|                                     |                 | Level 1                       | Level 2     | Level 3   |                  |
| <b>ASSETS</b>                       |                 |                               |             |           |                  |
| Cash and cash equivalents           | \$35,345        | \$35,345                      | \$—         | \$—       | \$35,345         |
| Securities available for sale       | 409,709         | 962                           | 408,747     | —         | 409,709          |
| Trading securities                  | 7,150           | 7,098                         | 52          | —         | 7,150            |
| Loans held for sale                 | 852             | —                             | 853         | —         | 853              |
| Net loans                           | 2,126,266       | —                             | —           | 2,126,824 | 2,126,824        |
| FHLB and other restricted interests | 17,035          | n/a                           | n/a         | n/a       | n/a              |
| Other equity interests              | 4,482           |                               |             |           | 4,482            |
| Interest rate swaps                 | 149             | —                             | 149         | —         | 149              |
| Accrued interest receivable         | 9,254           | 6                             | 2,651       | 6,597     | 9,254            |
| <b>LIABILITIES</b>                  |                 |                               |             |           |                  |
| Deposits                            | \$(2,167,815)   | \$(1,802,844)                 | \$(362,756) | \$—       | —\$(2,165,600)   |
| FHLB and other borrowings           | (257,359 )      | —                             | (257,361 )  | —         | (257,361 )       |
| Subordinated debentures             | (70,620 )       | —                             | (63,575 )   | —         | (63,575 )        |
| Interest rate swaps                 | (310 )          | —                             | (310 )      | —         | (310 )           |
| Accrued interest payable            | (554 )          | —                             | (554 )      | —         | (554 )           |

The methods utilized to estimate the fair value of financial instruments at December 31, 2017 did not necessarily represent an exit price. In accordance with our adoption of ASU 2016-01 in 2018, the methods utilized to measure the fair value of financial instruments at September 30, 2018 represent an approximation of exit price; however, an actual exit price may differ.

While estimates of fair value are based on management's judgment of the most appropriate factors as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets had been disposed of or the liabilities settled at that date, since market values may differ depending on various circumstances. The estimated fair values would also not apply to subsequent dates. Other equity interests fair value is based on the net asset values provided by underlying investment partnership. ASU 2015-7 removes the requirement to categorize within the fair value hierarchy all investments measured using the net asset value per share practical expedient and related disclosures.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the disclosures. Also, non-financial assets such as, among other things, the estimated earnings power of core deposits, the earnings potential of trust accounts, the trained workforce, and customer goodwill, which typically are not recognized on the balance sheet, may have value but are not included in the fair value disclosures.

#### 4. SECURITIES

Securities available for sale at September 30, 2018 and December 31, 2017 are as follows:

|                                     | September 30, 2018 |         |             |           | December 31, 2017 |         |            |           |
|-------------------------------------|--------------------|---------|-------------|-----------|-------------------|---------|------------|-----------|
|                                     | Amortized          |         | Unrealized  | Fair      | Amortized         |         | Unrealized | Fair      |
|                                     | Cost               | Gains   |             |           | Cost              | Gains   |            |           |
| U.S. gov't sponsored entities       | \$148,034          | \$178   | \$(2,703 )  | \$145,509 | \$108,578         | \$478   | \$(908 )   | \$108,148 |
| State & political subdivisions      | 137,848            | 1,643   | (1,096 )    | 138,395   | 134,428           | 3,609   | (314 )     | 137,723   |
| Residential & multi-family mortgage | 199,968            | 76      | (5,409 )    | 194,635   | 111,214           | 304     | (1,882 )   | 109,636   |
| Corporate notes & bonds             | 12,358             | 31      | (353 )      | 12,036    | 17,610            | 52      | (462 )     | 17,200    |
| Pooled SBA                          | 32,079             | 66      | (1,312 )    | 30,833    | 36,260            | 355     | (575 )     | 36,040    |
| Other                               | 1,020              | —       | (94 )       | 926       | 1,020             | —       | (58 )      | 962       |
| Total                               | \$531,307          | \$1,994 | \$(10,967 ) | \$522,334 | \$409,110         | \$4,798 | \$(4,199 ) | \$409,709 |



At September 30, 2018 and December 31, 2017, there were no holdings of securities of any one issuer, other than the U.S. government sponsored entities, in an amount greater than 10% of shareholders' equity. The Corporation's residential and multi-family mortgage securities are issued by government sponsored entities.

Trading securities at September 30, 2018 and December 31, 2017 are as follows:

|                                    | September<br>30, 2018 | December<br>31, 2017 |
|------------------------------------|-----------------------|----------------------|
| Corporate equity securities        | \$ 6,643              | \$ 5,125             |
| Mutual funds                       | 1,687                 | 1,499                |
| Certificates of deposit            | 228                   | 220                  |
| Corporate notes and bonds          | 278                   | 254                  |
| U.S. government sponsored entities | 51                    | 52                   |
| Total                              | \$ 8,887              | \$ 7,150             |

Securities with unrealized losses at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

September 30, 2018

| Description of Securities           | Less than 12 Months |                    | 12 Months or More |                    | Total         |                    |
|-------------------------------------|---------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|                                     | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| U.S. gov't sponsored entities       | \$63,025            | \$ (736 )          | \$70,211          | \$ (1,967 )        | \$133,236     | \$ (2,703 )        |
| State & political subdivisions      | 45,113              | (617 )             | 7,907             | (479 )             | 53,020        | (1,096 )           |
| Residential & multi-family mortgage | 106,762             | (2,196 )           | 62,880            | (3,213 )           | 169,642       | (5,409 )           |
| Corporate notes & bonds             | 5,229               | (29 )              | 4,676             | (324 )             | 9,905         | (353 )             |
| Pooled SBA                          | 7,326               | (106 )             | 19,377            | (1,206 )           | 26,703        | (1,312 )           |
| Other                               | —                   | —                  | 926               | (94 )              | 926           | (94 )              |
|                                     | \$227,455           | \$ (3,684 )        | \$165,977         | \$ (7,283 )        | \$393,432     | \$ (10,967 )       |

December 31, 2017

| Description of Securities             | Less than 12 Months |                    | 12 Months or More |                    | Total         |                    |
|---------------------------------------|---------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|                                       | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| U.S. gov't sponsored entities         | \$55,696            | \$ (540 )          | \$34,754          | \$ (368 )          | \$90,450      | \$ (908 )          |
| State & political subdivisions        | 15,890              | (69 )              | 4,104             | (245 )             | 19,994        | (314 )             |
| Residential and multi-family mortgage | 30,144              | (153 )             | 63,699            | (1,729 )           | 93,843        | (1,882 )           |
| Corporate notes & bonds               | 5,005               | (9 )               | 9,042             | (453 )             | 14,047        | (462 )             |
| Pooled SBA                            | —                   | —                  | 22,270            | (575 )             | 22,270        | (575 )             |
| Other                                 | —                   | —                  | 962               | (58 )              | 962           | (58 )              |
|                                       | \$106,735           | \$ (771 )          | \$134,831         | \$ (3,428 )        | \$241,566     | \$ (4,199 )        |

The Corporation evaluates securities for other-than-temporary impairment on a quarterly basis, or more frequently when economic or market conditions warrant such an evaluation.



A roll-forward of the other-than-temporary impairment amount related to credit losses for the three and nine months ended September 30, 2018 and 2017 is as follows:

|  | 2018 | 2017     |
|--|------|----------|
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, beginning of period | \$   | —\$2,071 |
| Credit losses previously recognized on securities sold during the period   | —    | (2,071 ) |
| Additional credit loss for which other-than-temporary impairment was not previously recognized   | —    | —        |
| Additional credit loss for which other-than-temporary impairment was previously recognized   | —    | —        |
| Balance of credit losses on debt securities for which a portion of other-than-temporary impairment was recognized in earnings, end of period       | \$   | —\$—     |

For the securities that comprise corporate notes and bonds and the securities that are issued by state and political subdivisions, management monitors publicly available financial information, such as filings with the SEC, in order to evaluate the securities for other-than-temporary impairment. For financial institution issuers, management monitors information from quarterly “call” report filings that are used to generate Uniform Bank Performance Reports. All other securities that were in an unrealized loss position at the balance sheet date were reviewed by management, and issuer-specific documents were reviewed as appropriate given the following considerations: When reviewing securities for other-than-temporary impairment, management considers the financial condition and near-term prospects of the issuer and whether downgrades by bond rating agencies have occurred. Management also considers the length of time and extent to which fair value has been less than cost, and whether management does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

As of September 30, 2018 and December 31, 2017, management concluded that the securities described in the previous paragraph were not other-than-temporarily impaired for the following reasons:

• There is no indication of any significant deterioration of the creditworthiness of the institutions that issued the securities.

All contractual interest payments on the securities have been received as scheduled, and no information has come to management’s attention through the processes previously described which would lead to a conclusion that future contractual payments will not be timely received.

The Corporation does not intend to sell and it is not more likely than not that it will be required to sell the securities in an unrealized loss position before recovery of its amortized cost basis.

On September 30, 2018 and December 31, 2017, securities carried at \$311,336 and \$319,575, respectively, were pledged to secure public deposits and for other purposes as provided by law.

Information pertaining to security sales on available for sale securities is as follows:

|                                       | Proceeds | Gross<br>Gains | Gross<br>Losses |
|---------------------------------------|----------|----------------|-----------------|
| Three months ended September 30, 2018 | \$—      | \$—            | \$—             |
| Three months ended September 30, 2017 | \$7,757  | \$76           | \$(71 )         |
| Nine months ended September 30, 2018  | \$—      | \$—            | \$—             |
| Nine months ended September 30, 2017  | \$15,374 | \$1,614        | \$(71 )         |

The tax provision related to these net realized gains was \$2 and \$540 during the three and nine months ended September 30, 2017.

The following is a schedule of the contractual maturity of securities available for sale, at September 30, 2018:

|                                       | Amortized Fair |            |
|---------------------------------------|----------------|------------|
|                                       | Cost           | Value      |
| 1 year or less                        | \$ 58,844      | \$ 58,554  |
| 1 year – 5 years                      | 164,854        | 163,471    |
| 5 years – 10 years                    | 70,767         | 70,223     |
| After 10 years                        | 3,775          | 3,692      |
|                                       | 298,240        | 295,940    |
| Residential and multi-family mortgage | 199,968        | 194,635    |
| Pooled SBA                            | 32,079         | 30,833     |
| Other securities                      | 1,020          | 926        |
| Total securities                      | \$ 531,307     | \$ 522,334 |

Mortgage and asset backed securities and pooled SBA securities are not due at a single date; periodic payments are received based on the payment patterns of the underlying collateral.

## 5. LOANS

Total net loans at September 30, 2018 and December 31, 2017 are summarized as follows:

|  | September<br>30, 2018 | December<br>31, 2017 |
|--|-----------------------|----------------------|
| Commercial, industrial, and agricultural | \$853,495             | \$749,138            |
| Commercial mortgages                     | 683,979               | 600,065              |
| Residential real estate                  | 760,342               | 713,347              |
| Consumer                                 | 85,888                | 80,193               |
| Credit cards                             | 7,434                 | 6,753                |
| Overdrafts                               | 325                   | 352                  |
| Less: unearned discount                  | (4,508 )              | (3,889 )             |
| allowance for loan losses                | (22,510 )             | (19,693 )            |
| Loans, net                               | \$2,364,445           | \$2,126,266          |

At September 30, 2018 and December 31, 2017, net unamortized loan fees of \$3,331 and \$2,574, respectively, have been included in the carrying value of loans.

The Corporation's outstanding loans and related unfunded commitments are primarily concentrated within Central and Western Pennsylvania, Central and Northeastern Ohio, and Western New York. The Bank attempts to limit concentrations within specific industries by utilizing dollar limitations to single industries or customers, and by entering into participation agreements with third parties. Collateral requirements are established based on management's assessment of the customer. The Corporation maintains lending policies to control the quality of the loan portfolio. These policies delegate the authority to extend loans under specific guidelines and underwriting standards. These policies are prepared by the Corporation's management and reviewed and ratified annually by the Corporation's Board of Directors.

Pursuant to the Corporation's lending policies, management considers a variety of factors when determining whether to extend credit to a customer, including loan-to-value ratios, FICO scores, quality of the borrower's financial statements, and the ability to obtain personal guarantees.

Commercial, industrial, and agricultural loans comprised 36% and 35% of the Corporation's total loan portfolio at September 30, 2018 and December 31, 2017, respectively. Commercial mortgage loans comprised 29% and 28% of the Corporation's total loan portfolio at September 30, 2018 and December 31, 2017, respectively. Management assigns a risk rating to all commercial loans at loan origination. The loan-to-value policy guidelines for commercial, industrial, and agricultural loans are generally a maximum of 80% of the value of business equipment, a maximum of 75% of the value of accounts receivable, and a maximum of 60% of the value of business inventory at loan origination. The loan-to-value policy guideline for commercial mortgage loans is generally a maximum of 85% of the

appraised value of the real estate.

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Residential real estate loans comprised 32% and 33% of the Corporation's total loan portfolio at September 30, 2018 and December 31, 2017, respectively. The loan-to-value policy guidelines for residential real estate loans vary depending on the collateral position and the specific type of loan. Higher loan-to-value terms may be approved with the appropriate private mortgage insurance coverage. The Corporation also originates and prices loans for sale into the secondary market. Loans so originated are classified as loans held for sale and are excluded from residential real estate loans reported above. The rationale for these sales is to mitigate interest rate risk associated with holding lower rate, long-term residential mortgages in the loan portfolio and to generate fee revenue from sales and servicing the loan. The Corporation also offers a variety of unsecured and secured consumer loan and credit card products which represented less than 10% of the total loan portfolio at both September 30, 2018 and December 31, 2017. Terms and collateral requirements vary depending on the size and nature of the loan.

Transactions in the allowance for loan losses for the three months ended September 30, 2018 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2018       | \$ 7,143                                       | \$ 10,615               | \$ 1,900                      | \$ 2,156 | \$ 101          | \$ 207     | \$ 22,122 |
| Charge-offs                                   | (30 )  | —                       | (212 )                        | (469 )   | (8 )            | (94 )      | (813 )    |
| Recoveries                                    | 3  | —                       | 55                            | 28       | 3               | 17         | 106       |
| Provision (benefit) for loan losses           | (536 )   | 682                     | 235                           | 608      | 11              | 95         | 1,095     |
| Allowance for loan losses, September 30, 2018 | \$ 6,580                                       | \$ 11,297               | \$ 1,978                      | \$ 2,323 | \$ 107          | \$ 225     | \$ 22,510 |

Transactions in the allowance for loan losses for the nine months ended September 30, 2018 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2018    | \$ 6,160                                       | \$ 9,007                | \$ 2,033                      | \$ 2,179 | \$ 120          | \$ 194     | \$ 19,693 |
| Charge-offs                                   | (61 )  | —                       | (289 )                        | (1,610 ) | (53 )           | (236 )     | (2,249 )  |
| Recoveries                                    | 165  | —                       | 67                            | 112      | 27              | 64         | 435       |
| Provision for loan losses                     | 316  | 2,290                   | 167                           | 1,642    | 13              | 203        | 4,631     |
| Allowance for loan losses, September 30, 2018 | \$ 6,580                                       | \$ 11,297               | \$ 1,978                      | \$ 2,323 | \$ 107          | \$ 225     | \$ 22,510 |

Transactions in the allowance for loan losses for the three months ended September 30, 2017 were as follows:

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|---|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, July 1, 2017       | \$ 5,563                                       | \$ 7,641                | \$ 1,670                      | \$ 2,068 | \$ 142          | \$ 185     | \$ 17,269 |
| Charge-offs                                   | (20 )  | (22 )                   | (130 )                        | (703 )   | (39 )           | (63 )      | (977 )    |
| Recoveries                                    | 36   | 3                       | —                             | 96       | 8               | 14         | 157       |
| Provision (benefit) for loan losses           | (223 )   | 472                     | 468                           | 627      | —               | 56         | 1,400     |
| Allowance for loan losses, September 30, 2017 | \$ 5,356                                       | \$ 8,094                | \$ 2,008                      | \$ 2,088 | \$ 111          | \$ 192     | \$ 17,849 |

Transactions in the allowance for loan losses for the nine months ended September 30, 2017 were as follows:

|  | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Overdrafts | Total     |
|--|--|-------------------------|-------------------------------|----------|-----------------|------------|-----------|
| Allowance for loan losses, January 1, 2017 | \$ 5,428                                       | \$ 6,753                | \$ 1,653                      | \$ 2,215 | \$ 93           | \$ 188     | \$ 16,330 |
| Charge-offs                                | (50 )  | (22 )                   | (328 )                        | (1,969 ) | (111 )          | (192 )     | (2,672 )  |

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|   |          |          |          |          |       |        |          |
|---|----------|----------|----------|----------|-------|--------|----------|
| Recoveries                                    | 167      | 197      | 73       | 110      | 23    | 71     | 641      |
| Provision (benefit) for loan losses           | (189     | ) 1,166  | 610      | 1,732    | 106   | 125    | 3,550    |
| Allowance for loan losses, September 30, 2017 | \$ 5,356 | \$ 8,094 | \$ 2,008 | \$ 2,088 | \$111 | \$ 192 | \$17,849 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and is based on the Corporation's impairment method as of September 30, 2018 and December 31, 2017. The recorded investment in loans excludes accrued interest and unearned discounts due to their insignificance. September 30, 2018

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer  | Credit<br>Cards | Overdrafts | Total        |
|---|--|-------------------------|-------------------------------|-----------|-----------------|------------|--------------|
| Allowance for loan losses:                      |  |                         |                               |           |                 |            |              |
| Ending allowance balance attributable to loans: |  |                         |                               |           |                 |            |              |
| Individually evaluated for impairment           | \$ —   | \$ 1                    | \$ —                          | \$ —      | \$ —            | \$ —       | \$ 1         |
| Collectively evaluated for impairment           | 6,343  | 5,062                   | 1,978                         | 2,323     | 107             | 225        | 16,038       |
| Acquired with deteriorated credit quality       | —  | —                       | —                             | —         | —               | —          | —            |
| Modified in a troubled debt restructuring       | 237  | 6,234                   | —                             | —         | —               | —          | 6,471        |
| Total ending allowance balance                  | \$ 6,580                                       | \$ 11,297               | \$ 1,978                      | \$ 2,323  | \$ 107          | \$ 225     | \$ 22,510    |
| Loans:  |  |                         |                               |           |                 |            |              |
| Individually evaluated for impairment           | \$ 1,500                                       | \$ 467                  | \$ —                          | \$ —      | \$ —            | \$ —       | \$ 1,967     |
| Collectively evaluated for impairment           | 847,197  | 669,989                 | 760,342                       | 85,888    | 7,434           | 325        | 2,371,175    |
| Acquired with deteriorated credit quality       | —  | 577                     | —                             | —         | —               | —          | 577          |
| Modified in a troubled debt restructuring       | 4,798  | 12,946                  | —                             | —         | —               | —          | 17,744       |
| Total ending loans balance                      | \$ 853,495                                     | \$ 683,979              | \$ 760,342                    | \$ 85,888 | \$ 7,434        | \$ 325     | \$ 2,391,463 |

|   | Commercial,<br>Industrial, and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Real<br>Estate | Consumer  | Credit<br>Cards | Overdrafts | Total        |
|---|--|-------------------------|-------------------------------|-----------|-----------------|------------|--------------|
| Allowance for loan losses:                      |  |                         |                               |           |                 |            |              |
| Ending allowance balance attributable to loans: |  |                         |                               |           |                 |            |              |
| Individually evaluated for impairment           | \$ 47  | \$ —                    | \$ —                          | \$ —      | \$ —            | \$ —       | \$ 47        |
| Collectively evaluated for impairment           | 5,868  | 3,563                   | 2,033                         | 2,179     | 120             | 194        | 13,957       |
| Acquired with deteriorated credit quality       | —  | —                       | —                             | —         | —               | —          | —            |
| Modified in a troubled debt restructuring       | 245  | 5,444                   | —                             | —         | —               | —          | 5,689        |
| Total ending allowance balance                  | \$ 6,160                                       | \$ 9,007                | \$ 2,033                      | \$ 2,179  | \$ 120          | \$ 194     | \$ 19,693    |
| Loans:  |  |                         |                               |           |                 |            |              |
| Individually evaluated for impairment           | \$ 1,187                                       | \$ 51                   | \$ —                          | \$ —      | \$ —            | \$ —       | \$ 1,238     |
| Collectively evaluated for impairment           | 742,738  | 586,845                 | 713,347                       | 80,193    | 6,753           | 352        | 2,130,228    |
| Acquired with deteriorated credit quality       | —  | 1,079                   | —                             | —         | —               | —          | 1,079        |
| Modified in a troubled debt restructuring       | 5,213  | 12,090                  | —                             | —         | —               | —          | 17,303       |
| Total ending loans balance                      | \$ 749,138                                     | \$ 600,065              | \$ 713,347                    | \$ 80,193 | \$ 6,753        | \$ 352     | \$ 2,149,848 |

The following tables present information related to loans individually evaluated for impairment, including loans modified in troubled debt restructurings, by portfolio segment as of September 30, 2018 and December 31, 2017 and for the three and nine months ended September 30, 2018 and 2017:

September 30, 2018

|  | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses Allocated |
|--|-----------------------------|------------------------|--|
| With an allowance recorded:              |                             |                        |  |
| Commercial, industrial, and agricultural | \$ 1,096                    | \$ 1,096               | \$ 237                                 |
| Commercial mortgage                      | 9,717                       | 8,991                  | 6,235                                  |
| Residential real estate                  | —                           | —                      | —                                      |
| With no related allowance recorded:      |                             |                        |  |
| Commercial, industrial, and agricultural | 5,918                       | 5,202                  | —                                      |
| Commercial mortgage                      | 5,464                       | 4,422                  | —                                      |
| Residential real estate                  | —                           | —                      | —                                      |
| Total                                    | \$ 22,195                   | \$ 19,711              | \$ 6,472                               |

December 31, 2017

|  | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses Allocated |
|--|-----------------------------|------------------------|--|
| With an allowance recorded:              |                             |                        |  |
| Commercial, industrial, and agricultural | \$ 1,915                    | \$ 1,915               | \$ 292                                 |
| Commercial mortgage                      | 9,940                       | 9,731                  | 5,444                                  |
| Residential real estate                  | —                           | —                      | —                                      |
| With no related allowance recorded:      |                             |                        |  |
| Commercial, industrial, and agricultural | 5,264                       | 4,485                  | —                                      |
| Commercial mortgage                      | 3,211                       | 2,410                  | —                                      |
| Residential real estate                  | —                           | —                      | —                                      |
| Total                                    | \$ 20,330                   | \$ 18,541              | \$ 5,736                               |

The unpaid principal balance of impaired loans includes the Corporation's recorded investment in the loan and amounts that have been charged off.

|  | Three months ended September<br>30, 2018   |                                      | Three months ended September<br>30, 2017   |                                      |
|--|--|--------------------------------------|--|--------------------------------------|
|  | Average Interest<br>Recorded<br>Investment | Cash Basis<br>Interest<br>Recognized | Average Interest<br>Recorded<br>Investment | Cash Basis<br>Interest<br>Recognized |
| With an allowance recorded:              |  |                                      |  |                                      |
| Commercial, industrial, and agricultural | \$3,460                                    | \$ 11                                | \$ 11                                      | \$ 20                                |
| Commercial mortgage                      | 9,042                                      | 37                                   | 37   | 77                                   |
| Residential real estate                  | —  | —                                    | —  | —                                    |
| With no related allowance recorded:      |  |                                      |  |                                      |
| Commercial, industrial, and agricultural | 5,569                                      | 69                                   | 69   | 23                                   |
| Commercial mortgage                      | 5,153                                      | 20                                   | 20   | 33                                   |
| Residential real estate                  | —  | —                                    | —  | —                                    |
| Total                                    | \$23,224                                   | \$ 137                               | \$ 137                                     | \$ 153                               |

|  | Nine months ended September 30, 2018 |                     |                                | Nine months ended September 30, 2017 |                     |                                |
|--|--------------------------------------|---------------------|--------------------------------|--------------------------------------|---------------------|--------------------------------|
|  | Average Recorded Investment          | Interest Recognized | Cash Basis Interest Recognized | Average Recorded Investment          | Interest Recognized | Cash Basis Interest Recognized |
| With an allowance recorded:              |                                      |                     |                                |                                      |                     |                                |
| Commercial, industrial, and agricultural | \$2,672                              | \$ 54               | \$ 54                          | \$1,413                              | \$ 56               | \$ 56                          |
| Commercial mortgage                      | 9,147                                | 111                 | 111                            | 12,497                               | 293                 | 293                            |
| Residential real estate                  | —                                    | —                   | —                              | —                                    | —                   | —                              |
| With no related allowance recorded:      |                                      |                     |                                |                                      |                     |                                |
| Commercial, industrial, and agricultural | 5,084                                | 160                 | 160                            | 1,927                                | 73                  | 73                             |
| Commercial mortgage                      | 4,511                                | 66                  | 66                             | 2,490                                | 100                 | 100                            |
| Residential real estate                  | —                                    | —                   | —                              | —                                    | —                   | —                              |
| Total                                    | \$21,414                             | \$ 391              | \$ 391                         | \$18,327                             | \$ 522              | \$ 522                         |

The following table presents the recorded investment in non-accrual loans and loans past due over 90 days still accruing interest by class of loans as of September 30, 2018 and December 31, 2017:

|  | September 30, 2018            |          | December 31, 2017             |          |
|--|-------------------------------|----------|-------------------------------|----------|
|  | Over 90 Days Still on Accrual | Past Due | Over 90 Days Still on Accrual | Past Due |
| Commercial, industrial, and agricultural | \$3,824                       | \$ 265   | \$1,869                       | \$ 78    |
| Commercial mortgages                     | 10,151                        | —        | 11,065                        | —        |
| Residential real estate                  | 4,767                         | 1,488    | 5,470                         | 338      |
| Consumer                                 | 140                           | 82       | 828                           | 17       |
| Credit cards                             | —                             | 26       | —                             | 44       |
| Total                                    | \$18,882                      | \$ 1,861 | \$19,232                      | \$ 477   |

Non-accrual loans and loans past due over 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the aging of the recorded investment in past due loans as of September 30, 2018 and December 31, 2017 by class of loans.

September 30, 2018

|                         | 30-59 Days Past Due                      | 60-89 Days Past Due | Greater Than 89 Days Past Due | Total Past Due | Loans Not Past Due | Total       |
|-------------------------|--|---------------------|-------------------------------|----------------|--------------------|-------------|
|                         | Commercial, industrial, and agricultural | \$ 76               | \$ 587                        | \$ 1,557       | \$2,220            | \$851,275   |
| Commercial mortgages    | 614                                      | —                   | 58                            | 672            | 683,307            | 683,979     |
| Residential real estate | 2,039                                    | 844                 | 4,937                         | 7,820          | 752,522            | 760,342     |
| Consumer                | 526                                      | 605                 | 830                           | 1,961          | 83,927             | 85,888      |
| Credit cards            | 30                                       | 33                  | 26                            | 89             | 7,345              | 7,434       |
| Overdrafts              | —  | —                   | —                             | —              | 325                | 325         |
| Total                   | \$ 3,285                                 | \$ 2,069            | \$ 7,408                      | \$12,762       | \$2,378,701        | \$2,391,463 |



December 31, 2017

|  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater Than<br>89 Days<br>Past Due | Total<br>Past<br>Due | Loans Not<br>Past Due | Total       |
|--|------------------------|------------------------|-------------------------------------|----------------------|-----------------------|-------------|
| Commercial, industrial, and agricultural | \$ 2,745               | \$ 646                 | \$ 748                              | \$4,139              | \$744,999             | \$749,138   |
| Commercial mortgages                     | 233                    | —                      | 292                                 | 525                  | 599,540               | 600,065     |
| Residential real estate                  | 2,290                  | 1,494                  | 4,655                               | 8,439                | 704,908               | 713,347     |
| Consumer                                 | 454                    | 307                    | 812                                 | 1,573                | 78,620                | 80,193      |
| Credit cards                             | 31                     | 10                     | 44                                  | 85                   | 6,668                 | 6,753       |
| Overdrafts                               | —                      | —                      | —                                   | —                    | 352                   | 352         |
| Total                                    | \$ 5,753               | \$ 2,457               | \$ 6,551                            | \$14,761             | \$2,135,087           | \$2,149,848 |

**Troubled Debt Restructurings**

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. All loans modified in troubled debt restructurings are performing in accordance with their modified terms as of September 30, 2018 and December 31, 2017 and no principal balances were forgiven in connection with the loan restructurings.

In order to determine whether a borrower is experiencing financial difficulty, the Corporation performs an evaluation using its internal underwriting policies of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without a loan modification. The Corporation has no further loan commitments to customers whose loans are classified as a troubled debt restructuring.

Generally, non-performing troubled debt restructurings are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The terms of certain loans have been modified as troubled debt restructurings. The modification of the terms of such loans included either or both of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents the number of loans, loan balances, and specific reserves for loans that have been restructured in a troubled debt restructuring as of September 30, 2018 and December 31, 2017.

|  | September 30, 2018 |                     | December 31, 2017  |                     |          |         |
|--|--------------------|---------------------|--------------------|---------------------|----------|---------|
|  | Number of<br>Loans | Specific<br>Reserve | Number of<br>Loans | Specific<br>Reserve |          |         |
| Commercial, industrial, and agricultural | 11                 | \$4,798             | \$237              | 11                  | \$5,213  | \$245   |
| Commercial mortgages                     | 13                 | 12,946              | 6,234              | 9                   | 12,090   | 5,444   |
| Residential real estate                  | —                  | —                   | —                  | —                   | —        | —       |
| Consumer                                 | —                  | —                   | —                  | —                   | —        | —       |
| Credit cards                             | —                  | —                   | —                  | —                   | —        | —       |
| Total                                    | 24                 | \$17,744            | \$6,471            | 20                  | \$17,303 | \$5,689 |

The following table presents information associated with the loans that were modified as troubled debt restructurings during the nine months ended September 30, 2018 and the three and nine months ended September 30, 2017. There were no loans modified as troubled debt restructurings during the three months ended September 30, 2018.

|  | Nine months ended September 30, 2018                       |   | Three and Nine months ended September 30, 2017             |   |
|--|--|---|--|---|
|  | Pre-Modification Outstanding<br>Not Recorded<br>Investment | Post-Modification Outstanding<br>Recorded<br>Investment | Pre-Modification Outstanding<br>Not Recorded<br>Investment | Post-Modification Outstanding<br>Recorded<br>Investment |
| Commercial, industrial, and agricultural | —  | \$ —  | 2  | \$ 324  |
| Commercial mortgages                     | 4  | 1,091   | 2  | 6,227   |
| Residential real estate                  | —  | —   | —  | —   |
| Consumer                                 | —  | —   | —  | —   |
| Credit cards                             | —  | —   | —  | —   |
| Total                                    | 4  | \$ 1,091  | 4  | \$ 6,551  |

The troubled debt restructurings described above increased the allowance for loan losses by \$113 and resulted in charge-offs of zero during the nine months ended September 30, 2018. The troubled debt restructurings described above increased the allowance for loan losses by \$169 and \$1,324 during the three and nine months ended September 30, 2017, respectively.

#### Credit Quality Indicators

The Corporation classifies commercial, industrial, and agricultural loans and commercial mortgage loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Loans with outstanding balances greater than \$1 million are analyzed at least semiannually and loans with outstanding balances of less than \$1 million are analyzed at least annually.

The Corporation uses the following definitions for risk ratings:

**Special Mention:** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Corporation's credit position at some future date.

**Substandard:** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.

**Doubtful:** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not rated as special mention, substandard, or doubtful are considered to be pass rated loans. All loans included in the following tables have been assigned a risk rating within 12 months of the balance sheet date.

September 30, 2018

|  | Pass        | Special<br>Mention | Substandard | Doubtful | Total       |
|--|-------------|--------------------|-------------|----------|-------------|
| Commercial, industrial, and agricultural | \$827,425   | \$10,304           | \$15,766    | \$ —     | \$853,495   |
| Commercial mortgages                     | 665,896     | 3,309              | 14,774      | —        | 683,979     |
| Total                                    | \$1,493,321 | \$13,613           | \$30,540    | \$ —     | \$1,537,474 |



December 31, 2017

|  | Pass        | Special<br>Mention | Substandard | Doubtful | Total        |
|--|-------------|--------------------|-------------|----------|--------------|
| Commercial, industrial, and agricultural | \$713,102   | \$16,726           | \$19,310    | \$       | —\$749,138   |
| Commercial mortgages                     | 581,631     | 4,419              | 14,015      | —        | 600,065      |
| Total                                    | \$1,294,733 | \$21,145           | \$33,325    | \$       | —\$1,349,203 |

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential real estate, consumer, and credit card loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential, consumer, and credit card loans based on payment activity as of September 30, 2018 and December 31, 2017:

|               | September 30, 2018            |          |                 | December 31, 2017             |          |                 |
|---------------|-------------------------------|----------|-----------------|-------------------------------|----------|-----------------|
|               | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards | Residential<br>Real<br>Estate | Consumer | Credit<br>Cards |
| Performing    | \$754,087                     | \$85,666 | \$7,408         | \$707,539                     | \$79,348 | \$6,709         |
| Nonperforming | 6,255                         | 222      | 26              | 5,808                         | 845      | 44              |
| Total         | \$760,342                     | \$85,888 | \$7,434         | \$713,347                     | \$80,193 | \$6,753         |

The Corporation's portfolio of consumer loans maintained within Holiday Financial Services Corporation ("Holiday") are considered to be subprime loans. Holiday is a subsidiary that offers small balance unsecured and secured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics than are typical in the Bank's consumer loan portfolio.

Holiday's loan portfolio is summarized as follows at September 30, 2018 and December 31, 2017:

|                         | September<br>30, 2018 | December<br>31, 2017 |
|-------------------------|-----------------------|----------------------|
| Consumer                | \$25,242              | \$23,428             |
| Less: unearned discount | (4,508)               | (3,889)              |
| Total                   | \$20,734              | \$19,539             |

## 6. DEPOSITS

Total deposits at September 30, 2018 and December 31, 2017 are summarized as follows:

|                                | September<br>30, 2018 | December<br>31, 2017 | Percentage<br>Change |
|--------------------------------|-----------------------|----------------------|----------------------|
| Checking, non-interest bearing | \$345,154             | \$321,858            | 7.2 %                |
| Checking, interest bearing     | 599,668               | 565,399              | 6.1 %                |
| Savings accounts               | 1,187,947             | 915,587              | 29.7 %               |
| Certificates of deposit        | 389,610               | 364,971              | 6.8 %                |
|                                | \$2,522,379           | \$2,167,815          | 16.4 %               |

## 7. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed using the weighted average number of shares determined for the basic computation plus the dilutive effect of potential common shares issuable under certain stock compensation plans. For the three and nine months ended September 30, 2018 and 2017, there were no outstanding stock options to include in the diluted earnings per share calculations. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding unvested stock awards are participating securities.



The computation of basic and diluted earnings per share is shown below:

|  | Three months ended September 30, |         | Nine months ended September 30, |          |
|--|----------------------------------|---------|---------------------------------|----------|
|  | 2018                             | 2017    | 2018                            | 2017     |
| Basic earnings per common share computation:   |                                  |         |                                 |          |
| Net income per consolidated statements of income   | \$9,236                          | \$7,246 | \$24,774                        | \$20,409 |
| Net earnings allocated to participating securities   | (40 )                            | (40 )   | (113 )                          | (120 )   |
| Net earnings allocated to common stock   | \$9,196                          | \$7,206 | \$24,661                        | \$20,289 |
| Distributed earnings allocated to common stock   | \$2,586                          | \$2,506 | \$7,607                         | \$7,521  |
| Undistributed earnings allocated to common stock   | 6,610                            | 4,700   | 17,054                          | 12,768   |
| Net earnings allocated to common stock   | \$9,196                          | \$7,206 | \$24,661                        | \$20,289 |
| Weighted average common shares outstanding, including shares considered participating securities | 15,285                           | 15,285  | 15,281                          | 15,188   |
| Less: Average participating securities   | (60 )                            | (78 )   | (67 )                           | (84 )    |
| Weighted average shares  | 15,225                           | 15,207  | 15,214                          | 15,104   |
| Basic earnings per common share  | \$0.60                           | \$0.47  | \$1.62                          | \$1.34   |
| Diluted earnings per common share computation:   |                                  |         |                                 |          |
| Net earnings allocated to common stock   | \$9,196                          | \$7,206 | \$24,661                        | \$20,289 |
| Weighted average shares and dilutive potential common shares                                     | 15,225                           | 15,207  | 15,214                          | 15,104   |
| Diluted earnings per common share  | \$0.60                           | \$0.47  | \$1.62                          | \$1.34   |

#### 8. DERIVATIVE INSTRUMENTS

On September 7, 2018, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2018 in order to hedge cash flows associated with \$10,000 of a subordinated note that was issued by the Corporation during 2007 and elected cash flow hedge accounting for the agreement. The Corporation's objective in using this derivative is to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2018 to September 15, 2023 without the exchange of the underlying notional amount. At September 30, 2018, the variable rate on the subordinated debt was 3.88% (LIBOR plus 155 basis points) and the Corporation was paying 4.53% (2.98% fixed rate plus 155 basis points).

On May 3, 2011, the Corporation executed an interest rate swap agreement with a 5 year term and an effective date of September 15, 2013 in order to hedge cash flows associated with \$10,000 of a subordinated note discussed above. The Corporation's objective in using this derivative was to add stability to interest expense and to manage its exposure to interest rate risk. The interest rate swap involves the receipt of variable-rate amounts in exchange for fixed-rate payments from September 15, 2013 to September 15, 2018 without exchange of the underlying notional amount. As of September 30, 2018 and December 31, 2017, no derivatives were designated as fair value hedges or hedges of net investments in foreign operations. Additionally, the Corporation does not use derivatives for trading or speculative purposes and currently does not have any derivatives that are not designated as hedges.

The following tables provide information about the amounts and locations of activity related to the interest rate swaps designated as cash flow hedges within the Corporation's consolidated balance sheet and statement of income as of September 30, 2018 and December 31, 2017 and for the three and nine months ended September 30, 2018 and 2017:

|                         | Balance Sheet Location                 | Fair value as of September 30, 2018 | December 31, 2017 |
|-------------------------|--|-------------------------------------|-------------------|
| Interest rate contracts | Accrued interest and other liabilities | \$9                                 | \$(161 )          |



|   |       |   |         |                 |      |
|---|-------|---|---------|-----------------|------|
| For the Three Months Ended September 30, 2018 | (a)   | (b)   | (c)     | (d)             | (e)  |
| Interest rate contracts                       | \$36  | Interest expense –<br>subordinated debentures | \$(44 ) | Other<br>income | \$ — |
| For the Nine Months Ended September 30, 2018  | (a)   | (b)   | (c)     | (d)             | (e)  |
| Interest rate contracts                       | \$134 | Interest expense –<br>subordinated debentures | \$(149) | Other<br>income | \$ — |
| For the Three Months Ended September 30, 2017 | (a)   | (b)   | (c)     | (d)             | (e)  |
| Interest rate contracts                       | \$46  | Interest expense –<br>subordinated debentures | \$(71 ) | Other<br>income | \$ — |
| For the Nine Months Ended September 30, 2017  | (a)   | (b)   | (c)     | (d)             | (e)  |
| Interest rate contracts                       | \$141 | Interest expense –<br>subordinated debentures | \$(220) | Other<br>income | \$ — |

(a) Amount of Gain or (Loss) Recognized in Other Comprehensive Loss on Derivative (Effective Portion), net of tax

(b) Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)

(c) Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)

(d) Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

(e) Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)

Amounts reported in accumulated other comprehensive loss related to the interest rate swap will be reclassified to interest expense as interest payments are made on the subordinated debentures. Such amounts reclassified from accumulated other comprehensive loss to interest expense in the next twelve months are expected to be \$65.

The Corporation has entered into certain interest rate swap contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Corporation enters into an interest rate swap with a customer while at the same time entering into an offsetting interest rate swap with another financial institution. In connection with each swap transaction, the Corporation agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. Concurrently, the Corporation agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the Corporation's customers to effectively convert a variable rate loan to a fixed rate. Because the Corporation acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts offset each other and do not impact the Corporation's results of operations.

The Corporation pledged cash collateral to another financial institution with a balance \$750 as of both September 30, 2018 and December 31, 2017. This balance is included in interest bearing deposits with other banks on the consolidated balance sheets. The Corporation does not require its customers to post cash or securities as collateral on its program of back-to-back swaps. However, certain language is included in the International Swaps and Derivatives Association agreement and loan documents where, in default situations, the Corporation is permitted to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Corporation may be required to post additional collateral to swap counterparties in the future in proportion to potential increases in unrealized loss positions.

The following table provides information about the amounts and locations of activity related to the back-to-back interest rate swaps within the Corporation's consolidated balance sheet as of September 30, 2018 and December 31, 2017:

| Notional<br>Amount | Weighted<br>Average<br>Maturity | Weighted<br>Average<br>Fixed Rate | Weighted Average<br>Variable Rate | Fair<br>Value |
|--------------------|---------------------------------|-----------------------------------|-----------------------------------|---------------|
|--------------------|---------------------------------|-----------------------------------|-----------------------------------|---------------|



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(in years)

September 30, 2018

3rd Party interest rate swaps \$22,278 7.7 3.88 % 1 month LIBOR + 1.23% \$(182) (a)

Customer interest rate swaps (22,278 ) 7.7 3.88 % 1 month LIBOR + 1.23% 182 (b)

December 31, 2017

3rd Party interest rate swaps \$11,848 8.0 4.51 % 1 month LIBOR + 2.37% \$149 (a)

Customer interest rate swaps (11,848 ) 8.0 4.51 % 1 month LIBOR + 2.37% (149 ) (b)

(a) Reported in accrued interest receivable and other assets within the consolidated balance sheets

(b) Reported in accrued interest payable and other liabilities within the consolidated balance sheets

## 9. REVENUE FROM CONTRACTS WITH CUSTOMERS

The Corporation adopted Accounting Standards Update (ASU) 2014-9, "Revenue from Contracts with Customers (Topic 606)" using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-9 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASU 2014-9 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Management determined that the primary sources of revenue emanating from interest and dividend income on loans and investment securities along with non-interest revenue resulting from security gains, loan servicing, gains on the sale of loans, commitment fees, fees from financial guarantees, certain credit cards fees, gains (losses) on sale of other real estate owned not financed by the Corporation, is not within the scope of (ASU) 2014-9. As a result, no changes were made during the period related to these sources of revenue, which comprised 90.8% and 90.7% of the total revenue of the Corporation for the three and nine months ended September 30, 2018, respectively.

The following tables depict the disaggregation of revenue derived from contracts with customers to depict the nature, amount, timing, and uncertainty of revenue and cash flows for the three and nine months ended September 30, 2018 and 2017.

|   | Three Months<br>Ended<br>September 30,<br>2018 | Three Months<br>Ended<br>September 30,<br>2017 |
|---|--|--|
| Non-interest Income                                     |  |  |
| Service charges on deposit accounts                     | \$ 1,584                                       | \$ 1,244                                       |
| Wealth and asset management fees                        | 1,031  | 952  |
| Mortgage banking (1)                                    | 283  | 237  |
| Card processing and interchange income                  | 1,066  | 942  |
| Net realized gains on available-for-sale securities (1) | —  | 5  |
| Other income  | 1,969  | 1,652  |
| Total non-interest income                               | \$ 5,933                                       | \$ 5,032                                       |

(1)Not within scope of ASU 2014-9

|   | Nine<br>Months<br>Ended<br>September<br>30, 2018 | Nine<br>Months<br>Ended<br>September<br>30, 2017 |
|---|--|--|
| Non-interest Income                                     |  |  |
| Service charges on deposit accounts                     | \$ 4,102   | \$ 3,499   |
| Wealth and asset management fees                        | 3,151  | 2,775  |
| Mortgage banking (1)                                    | 801  | 668  |
| Card processing and interchange income                  | 3,140  | 2,790  |
| Net realized gains on available-for-sale securities (1) | —  | 1,543  |
| Other income  | 5,096  | 4,619  |
| Total non-interest income                               | \$ 16,290  | \$ 15,894  |

(1)Not within scope of ASU 2014-9

The types of non-interest income within the scope of the standard that is material to the consolidated financial statements are services charges on deposit accounts, wealth and asset management fee income, and card processing and interchange income.

Service charges on deposit accounts: The Corporation earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed, as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Services charges on deposits are withdrawn from the customer's account balance.

Wealth and asset management fees: The Corporation earns wealth and asset management fees from its contracts with trust and brokerage customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Corporation provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management at month end. Fees for these services are billed to customers on a monthly or quarterly basis and are recorded as revenue at the end of the period for which the wealth and asset management services have been performed. Other performance obligations, such as the delivery of account statements to customers, are generally considered immaterial to the overall transaction price.

Card processing and interchange income: The Corporation earns interchange fees from check card and credit card transactions conducted through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Other income: The Corporation's other income includes sources such as bank owned life insurance, certain service fees, gains (losses) on sales of fixed assets, and gains (losses) on sale of other real estate owned. The service fees are recognized in the same manner as the service charges mentioned above. While gains on the sale of other real estate owned are generally within the scope of (ASU) 2014-9, the Corporation does not finance the sale of transactions and as such there is no change in revenue recognition.

#### 10. CONTINGENCY

On March 28, 2018, the Corporation received a notice of assessment from the Pennsylvania Department of Revenue that reported a sales tax assessment amount of \$824 plus interest and penalties of \$339 resulting in a total assessed balance of

\$1,163. The notice of assessment covers the period from January 1, 2013 through July 31, 2016. The Corporation has evaluated the specific items on which sales tax has been assessed in conjunction with its legal counsel and has determined that it is probable that the Corporation has some liability based on a review of the Pennsylvania tax laws that apply to the assessed items. The Corporation's reasonable estimate of this liability is \$96, which has been accrued and reported in state and local tax expense in the accompanying consolidated statement of income for the nine months ended September 30, 2018. The remaining balance that has not been accrued relates primarily to sales tax assessments associated with data processing and banking equipment maintenance, which the Corporation's management and legal counsel have concluded were improperly assessed based on current Pennsylvania sales tax law. The ultimate resolution of this matter, which may take in excess of one year, could result in an additional expense up to the total amount assessed.

#### 11. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2018-14, "Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans." ASU 2018-14 amends ASC 715-20, "Compensation - Retirement Benefits - Defined Benefit Plans - General." The amended guidance modifies the disclosure requirements for employers that sponsor defined benefit pension or other post-retirement plans by removing and adding certain disclosures for these plans. The eliminated disclosures include (a) the amounts in accumulated Other Comprehensive Income ("OCI") expected to be recognized in net periodic benefit costs over the next fiscal year, and (b) the effects of a one percentage point change in assumed health care cost trend rates on the net periodic benefit costs and the benefit obligation for post-retirement health care benefits. Additional disclosures include descriptions of significant gains and losses affecting the benefit obligation for the period. The update will be effective for annual reporting periods beginning after December 15, 2020, with early adoption permitted for annual reporting periods beginning after December 15, 2019. Management is currently evaluating the impact of the adoption of ASU 2018-14 on the Corporation's financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement." ASU 2018-13 modifies disclosure

requirements on fair value measurements based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. The update will be effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted for interim and annual

reporting periods beginning after December 15, 2018. Management is currently evaluating the impact of the adoption of ASU 2018-13 on the Corporation's financial statements.

In January 2017, the FASB issued an update (ASU 2017-04, Intangibles – Goodwill and Other) which is intended to simplify the measurement of goodwill in periods following the date on which the goodwill is initially recorded. Under the amendments in this update, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. However, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. A public business entity that is a U.S. Securities and Exchange Commission filer should adopt the amendments in this update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of ASU 2017-04 is not expected to have a material effect on the Corporation's financial statements.

In August 2016, the FASB issued an update (ASU 2016-15, Statement of Cash Flows) which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in this update apply to all entities, including business entities and not-for-profit entities that are required to present a statement of cash flows, and are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The adoption of ASU 2016-15 did not have a material effect on the Corporation's financial statements.

In June 2016, the FASB issued an update (ASU 2016-13, Financial Instruments – Credit Losses) which will require recognition of an entity's current estimate of all expected credit losses for assets measured at amortized cost. The amendments in ASU 2016-13 eliminate the probable initial recognition threshold in current GAAP. In addition, the amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually, such as loans. The update will be effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2018. The Corporation has formed a committee comprised of individuals from different disciplines, including credit administration, finance, loan servicing and information technology, to evaluate the requirements of the new standard and the impact it will have on current processes. Management has performed a data gap analysis, and is developing analytical approaches to determine CECL model inputs. The Corporation has also engaged a software vendor to assist in implementing a CECL production platform. The new guidance is expected to be heavily influenced by an assessment of the composition, characteristics, and credit quality of the Corporation's loan and investment securities portfolio as well as the economic conditions in effect at the adoption date. The impact to the financial statements is yet to be determined.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires a lessee to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The update will be effective for reporting periods beginning after December 15, 2018. Early adoption is permitted. Management is currently evaluating the impact of the adoption of ASU 2016-02 on the Corporation's financial statements and anticipates an increase in the Corporation's assets and liabilities of approximately \$15 million.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities". ASU 2016-01 provides updated accounting and reporting requirements for both public and non-public entities. The most significant provisions that will impact the Corporation are: 1) equity securities available for sale will be measured at fair value, with the changes in fair value recognized in the income statement; 2) eliminate the

requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments at amortized cost on the balance sheet; 3) utilization of exit price notion when measuring the fair value of financial instruments for disclosure purposes; 4) require separate presentation of both financial assets and liabilities by measurement category and form of financial asset on the balance sheet or accompanying notes to the financial statements. The update was effective on January 1, 2018, using a cumulative-effect adjustment to the balance sheet as of the beginning of the year, but resulted in the use of an exit price, rather than an entrance price, to determine fair value of loans not measured at fair value on a non-recurring basis. The adoption of ASU 2016-01 on January 1, 2018 did not have a material effect on the Corporation's financial statements.

## ITEM 2

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of the consolidated financial statements of the Corporation is presented to provide insight into management's assessment of financial results. The Corporation's subsidiary, CNB Bank (the "Bank"), provides financial services to individuals and businesses primarily within its primary market area of the Pennsylvania counties of Blair, Cambria, Cameron, Centre, Clearfield, Crawford, Elk, Indiana, Jefferson, and McKean. As ERIEBANK, a division of CNB Bank, the Bank operates in the Pennsylvania counties of Crawford, Erie, and Warren and the Ohio counties of Ashtabula and Lake. As FCBank, a division of CNB Bank, the Bank operates in the Ohio counties of Crawford, Richland, Ashland, Wayne, Marion, Morrow, Knox, Delaware, and Franklin. As BankOnBuffalo, a division of CNB Bank, the Bank operates in Erie and Niagara counties, New York.

The Bank is subject to regulation, supervision and examination by the Pennsylvania State Department of Banking as well as the Federal Deposit Insurance Corporation. The financial condition and results of operations of the Corporation and its consolidated subsidiaries are not necessarily indicative of future performance. CNB Securities Corporation is incorporated in Delaware and currently maintains investments in debt and equity securities. CNB Insurance Agency, incorporated in Pennsylvania, provides for the sale of nonproprietary annuities and other insurance products. Holiday Financial Services Corporation ("Holiday"), incorporated in Pennsylvania, offers small balance secured and unsecured loans, primarily collateralized by automobiles and equipment, to borrowers with higher risk characteristics. CNB Risk Management, Inc., incorporated in Delaware, insures against risks unique to the operations of the Corporation.

When we use the terms "we", "us" and "our", we mean CNB Financial Corporation and its subsidiaries. Management's discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements and related notes.

The following discussion should be read in conjunction with the Corporation's Consolidated Financial Statements and Notes thereto, for the year ended December 31, 2017, included in its 2017 Form 10-K, and in conjunction with the Consolidated Financial Statements and Notes thereto included in Item 1 of this report. Operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results for the full year ending December 31, 2018, or any future period. All dollar amounts are stated in thousands, except share and per share data and other amounts as indicated.

#### GENERAL OVERVIEW

Management concentrates on return on average equity, earnings per share, asset quality, and other metrics to measure the performance of the Corporation. The interest rate environment will continue to play an important role in the future earnings of the Corporation. During the past several years, in order to address the historic lows on interest rates that are primarily tied to short-term rates, such as the Prime Rate, the Corporation has taken a variety of measures including instituting rate floors on our commercial lines of credit and home equity lines.

Non-interest costs are expected to increase with the growth of the Corporation; however, management's growth strategies are expected to also result in an increase in earning assets as well as enhanced non-interest income which is expected to more than offset increases in non-interest expenses in 2018 and beyond. While past results are not an indication of future earnings, management believes the Corporation is well-positioned to sustain core earnings during 2018.

CNB Risk Management, Inc., a wholly-owned subsidiary of the Corporation which was formed and began operations on June 1, 2018, is a Delaware-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CNB Risk Management, Inc. pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves. CNB Risk Management, Inc. is subject to regulations of the State of Delaware and undergoes periodic examinations by the Delaware Division of Insurance.

#### CASH AND CASH EQUIVALENTS



Cash and cash equivalents totaled \$36.5 million at September 30, 2018 compared to \$35.3 million at December 31, 2017. Cash and cash equivalents fluctuate based on the timing and amount of liquidity events that occur in the normal course of business.

Management believes the liquidity needs of the Corporation are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, Federal Home Loan Bank financing, and the portions of the securities and loan portfolios that mature within one year. The Corporation expects that these sources of funds will enable it to meet cash obligations and off-balance sheet commitments as they come due.

#### SECURITIES

Securities available for sale and trading securities increased by \$112.6 million or 27.5% since December 31, 2017. The Corporation's objective is to maintain the securities portfolio at a size that ranges between 15% and 20% of total assets in order to appropriately balance the earnings and liquidity that the portfolio provides. As of September 30, 2018 and December 31, 2017, the securities portfolio as a percentage of total assets was 17.0% and 15.1%, respectively. The footnotes to the consolidated financial statements provide more detail concerning the composition of the Corporation's securities portfolio and the process for evaluating securities for other-than-temporary impairment. The Corporation generally buys into the market over time and does not attempt to "time" its transactions. In doing this, the highs and lows of the market are averaged into the portfolio and the overall effect of different rate environments is minimized. The Corporation monitors the earnings performance and the effectiveness of the liquidity of the securities portfolio on a regular basis through meetings of the Asset/Liability Committee of the Corporation's Board of Directors ("ALCO"). The ALCO also reviews and manages interest rate risk for the Corporation. Through active balance sheet management and analysis of the securities portfolio, a sufficient level of liquidity is maintained to satisfy depositor requirements and various credit needs of our customers.

#### LOANS

The Corporation experienced an increase in loans, net of unearned discount, of \$241.0 million, or 11.2%, during the first nine months of 2018. The Corporation's newest division, BankOnBuffalo, headquartered in northwestern New York, had an increase in loans of \$113.8 million during the first nine months of 2018. Lending efforts consist principally of commercial and retail lending, which includes single family residential mortgages and other consumer loans. The Corporation views commercial lending as its competitive advantage and continues to focus on this area by hiring and retaining experienced loan officers and supporting them with quality credit analysis. The Corporation expects loan demand to be solid and loan balances to grow throughout the remainder of 2018.

#### ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established by provisions for losses in the loan portfolio as well as overdrafts in deposit accounts. These provisions are charged against current income. Loans and overdrafts deemed not collectible are charged off against the allowance while any subsequent collections are recorded as recoveries and increase the allowance.

|   | Nine months<br>ended<br>September<br>30, 2018 | Year ended<br>December<br>31, 2017 | Nine months<br>ended<br>September<br>30, 2017 |
|---|---|------------------------------------|---|
| Balance at beginning of period                | \$19,693                                      | \$16,330                           | \$16,330                                      |
| Charge-offs:                                  |   |                                    |   |
| Commercial, industrial, and agricultural      | (61 )   | (544 )                             | (50 )   |
| Commercial mortgages                          | —   | (116 )                             | (22 )   |
| Residential real estate                       | (289 )  | (466 )                             | (328 )  |
| Consumer                                      | (1,610 )                                      | (2,555 )                           | (1,969 )                                      |
| Credit cards                                  | (53 )   | (144 )                             | (111 )  |
| Overdrafts                                    | (236 )  | (252 )                             | (192 )  |
|   | (2,249 )                                      | (4,077 )                           | (2,672 )                                      |
| Recoveries:                                   |   |                                    |   |
| Commercial, industrial, and agricultural      | 165   | 235                                | 167   |
| Commercial mortgages                          | —   | 197                                | 197   |
| Residential real estate                       | 67  | 78                                 | 73  |
| Consumer                                      | 112   | 161                                | 110   |
| Credit cards                                  | 27  | 27                                 | 23  |
| Overdraft deposit accounts                    | 64  | 87                                 | 71  |
|   | 435   | 785                                | 641   |
| Net charge-offs                               | (1,814 )                                      | (3,292 )                           | (2,031 )                                      |
| Provision for loan losses                     | 4,631   | 6,655                              | 3,550   |
| Balance at end of period                      | \$22,510                                      | \$19,693                           | \$17,849                                      |
| Loans, net of unearned                        | \$2,386,955                                   | \$2,145,959                        | \$2,098,574                                   |
| Allowance to net loans                        | 0.94  | % 0.92                             | % 0.85  |
| Net charge-offs to average loans (annualized) | 0.11  | % 0.16                             | % 0.14  |
| Nonperforming assets                          | \$21,175                                      | \$20,427                           | \$20,583                                      |
| Nonperforming % of total assets               | 0.68  | % 0.74                             | % 0.75  |

The adequacy of the allowance for loan losses is subject to a formal analysis by the Credit Administration and Finance Departments of the Corporation. As part of the formal analysis, delinquencies and losses are monitored monthly. The loan portfolio is divided into several categories in order to better analyze the entire pool. First is a selection of classified loans that is given a specific reserve. The remaining loans are pooled, by category, into these segments:

Reviewed

Commercial, industrial, and agricultural

Commercial mortgages

Homogeneous

Residential real estate

Consumer

Credit cards

Overdrafts

The reviewed loan pools are further segregated into four categories: special mention, substandard, doubtful, and pass rated. Historical loss factors are calculated for each pool excluding overdrafts based on the previous eight quarters of experience. The homogeneous pools are evaluated by analyzing the historical loss factors from the most previous eight quarter ends.

The historical loss factors for both the reviewed and homogeneous pools are adjusted based on the following six qualitative factors:

• levels of and trends in delinquencies, non-accrual loans, and classified loans;  
• trends in volume and terms of loans;  
• effects of any changes in lending policies and procedures;  
• experience and ability of management;  
• national and local economic trends and conditions; and  
• concentrations of credit.

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The methodology described above was created using the experience of the Corporation's management team, guidance from the regulatory agencies, expertise of a third-party loan review provider, and discussions with peers. The resulting factors are applied to the pool balances in order to estimate the probable risk of loss within each pool. Prudent business practices dictate that the level of the allowance, as well as corresponding charges to the provision for loan losses, should be commensurate with identified areas of risk within the loan portfolio and the attendant risks inherent therein. The quality of the credit risk management function and the overall administration of this vital segment of the Corporation's assets are critical to the ongoing success of the Corporation.

The previously mentioned analysis considers numerous historical and other factors to analyze the adequacy of the allowance and current period charges against the provision for loan losses. Management uses the analysis to compare and plot the actual level of the allowance against the aggregate amount of loans adversely classified in order to compute the estimated probable losses associated with those loans. Management then determines the current adequacy of the allowance and evaluates trends that may be developing. The volume and composition of the Corporation's loan portfolio continue to reflect growth in commercial credits including commercial real estate loans.

As mentioned in the Loans section of this analysis, management considers commercial lending to be a competitive advantage and continues to focus on this area as part of its strategic growth initiatives. However, management recognizes and considers the fact that risk is more pronounced in these types of credits and is, to a greater degree than with other loans, driven by the economic environment in which the debtor's business operates.

In the first nine months of 2018, one commercial real estate loan that was impaired at year end 2017 experienced further deterioration in the financial condition of the borrower, resulting in an additional provision for loan losses of \$623 thousand.

In the second quarter of 2018, CNB identified a commercial and industrial relationship that, while performing in accordance with its contractual terms and current with scheduled principal and interest payments, filed for bankruptcy. As a result, CNB recorded a specific loan loss reserve for this impaired loan of \$758 thousand as of June 30, 2018.

During the quarter ended September 30, 2018, the customer sold its business and CNB received full repayment of the outstanding principal balance of \$5.5 million along with previously outstanding interest and fees totaling \$127 thousand.

Management believes that the allowance for loan losses is reasonable and adequate to absorb probable incurred losses in the Corporation's portfolio at September 30, 2018.

#### FUNDING SOURCES

The Corporation considers deposits, short-term borrowings, and term debt when evaluating funding sources. Deposits increased \$354.6 million from \$2.17 billion at December 31, 2017 to \$2.52 billion at September 30, 2018 primarily resulting from a deposit growth strategy in the western New York market and from the Private Client Solutions division.

Periodically, the Corporation utilizes term borrowings from the Federal Home Loan Bank ("FHLB") and other lenders to meet funding needs. Management plans to maintain access to short-term and long-term borrowings as an available funding source.

#### SHAREHOLDERS' EQUITY AND CAPITAL RATIOS AND METRICS

The Corporation's capital continued to provide a base for profitable growth through September 30, 2018. Total shareholders' equity was \$254.4 million at September 30, 2018 and \$243.9 million at December 31, 2017. In the first nine months of 2018, the Corporation earned \$24.8 million and declared dividends of \$7.6 million, resulting in a dividend payout ratio of 30.9% of net income.

The Corporation has complied with the standards of capital adequacy mandated by government regulations. Bank regulators have established "risk-based" capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks of various assets banks hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, 100%, or 150% (highest risk assets), is assigned to each asset on the balance sheet.



The Corporation's capital ratios, book value per share and tangible book value per share as of September 30, 2018 and December 31, 2017 are as follows:

|  | September 30,<br>2018 | December 31,<br>2017 |   |  |
|--|-----------------------|----------------------|---|--|
| Total risk-based capital ratio             | 13.66                 | % 14.32              | % |  |
| Tier 1 capital ratio                       | 10.54                 | % 10.97              | % |  |
| Common equity tier 1 ratio                 | 9.68                  | % 10.00              | % |  |
| Leverage ratio                             | 8.06                  | % 8.45               | % |  |
| Tangible common equity/tangible assets (1) | 6.95                  | % 7.46               | % |  |
| Book value per share                       | \$ 16.64              | \$ 15.98             |   |  |
| Tangible book value per share (1)          | \$ 14.05              | \$ 13.33             |   |  |

(1) Tangible common equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity is calculated by excluding the balance of goodwill and core deposit intangibles from the calculation of shareholders' equity. Tangible assets is calculated by excluding the balance of goodwill and core deposit intangibles from the calculation of total assets. Tangible book value per share is calculated by dividing tangible common equity by the number of shares outstanding. The Corporation believes that these non-GAAP financial measures provide information to investors that is useful in understanding its financial condition because they are additional measures used to assess capital adequacy. Because not all companies use the same calculation of tangible common equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of these non-GAAP financial measures is provided below.

|  | September 30,<br>2018 | December 31,<br>2017 |   |  |
|--|-----------------------|----------------------|---|--|
| Shareholders' equity                   | \$254,376             | \$243,910            |   |  |
| Less goodwill                          | 38,730                | 38,730               |   |  |
| Less core deposit intangible           | 907                   | 1,625                |   |  |
| Tangible common equity                 | \$214,739             | \$203,555            |   |  |
| Total assets                           | \$3,129,313           | \$2,768,773          |   |  |
| Less goodwill                          | 38,730                | 38,730               |   |  |
| Less core deposit intangible           | 907                   | 1,625                |   |  |
| Tangible assets                        | \$3,089,676           | \$2,728,418          |   |  |
| Ending shares outstanding              | 15,285,430            | 15,264,740           |   |  |
| Tangible book value per share          | \$ 14.05              | \$ 13.33             |   |  |
| Tangible common equity/tangible assets | 6.95                  | % 7.46               | % |  |

#### LIQUIDITY

Liquidity measures an organization's ability to meet cash obligations as they come due. The consolidated statement of cash flows provides analysis of the Corporation's cash and cash equivalents. Additionally, management considers that portion of the loan and investment portfolio that matures within one year to be part of the Corporation's liquid assets. The Corporation's liquidity is monitored by both management and the ALCO, which establishes and monitors ranges of acceptable liquidity. Management believes the Corporation's current liquidity position is acceptable.

#### OFF BALANCE SHEET ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

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The contractual amount of financial instruments with off balance sheet risk was as follows at September 30, 2018 and December 31, 2017:

|                           | September 30, 2018 |               | December 31, 2017 |               |
|---------------------------|--------------------|---------------|-------------------|---------------|
|                           | Fixed Rate         | Variable Rate | Fixed Rate        | Variable Rate |
| Commitments to make loans | \$54,735           | \$ 178,461    | \$49,622          | \$ 191,864    |
| Unused lines of credit    | 15,968             | 459,815       | 16,342            | 414,885       |
| Standby letters of credit | 14,604             | 1,439         | 13,706            | 1,524         |

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments at September 30, 2018 have interest rates ranging from 2.45% to 18.00% and maturities ranging from 12 months to 35 years. The fixed rate loan commitments at December 31, 2017 have interest rates ranging from 1.00% to 18.00% and maturities ranging from 8 months to 35 years.

The Corporation makes investments in limited partnerships, including certain small business investment corporations and low income housing partnerships. As of September 30, 2018 and December 31, 2017, unfunded capital commitments totaled \$1.4 million and \$3.5 million, respectively for the small business investment corporations and \$3.5 million and \$2.5 million for the low income housing partnerships, respectively. At September 30, 2018 and December 31, 2017, capital contributions to the small business investment corporations were \$6.6 million and \$4.5 million, respectively and capital contributions to the low income housing partnerships were \$5.0 million and \$3.5 million, respectively.

## RESULTS OF OPERATIONS

Three Months Ended September 30, 2018 and 2017

### OVERVIEW OF THE INCOME STATEMENT

The Corporation had net income of \$9.2 million in the third quarter of 2018 and \$7.2 million in the third quarter of 2017. The earnings per diluted share were \$0.60 in the third quarter of 2018 and \$0.47 in the third quarter of 2017. The annualized return on assets and return on equity for the third quarter of 2018 are 1.20% and 14.59% compared to 1.06% and 11.88% for the third quarter of 2017.

### INTEREST INCOME AND EXPENSE

Net interest margin on a fully tax equivalent basis was 3.79% and 3.82% for the quarters ended September 30, 2018 and 2017, respectively. The yield on earning assets increased 20 basis points to 4.78% for the quarter ended September 30, 2018 from 4.58% for the quarter ended September 30, 2017. The cost of interest-bearing liabilities increased 35 basis points to 1.22% for the quarter ended September 30, 2018 from 0.87% for the quarter ended September 30, 2017.

Total interest and dividend income increased by 21.3% to \$34.0 million for the quarter ended September 30, 2018 from \$28.1 million for the quarter ended September 30, 2017. Net interest income increased by 14.3% to \$26.9 million for the quarter ended September 30, 2018 from \$23.5 million for the quarter ended September 30, 2017.

### PROVISION FOR LOAN LOSSES

During the quarter ended September 30, 2018, the Corporation recorded a provision for loan losses of \$1.1 million, as compared to a provision for loan losses of \$1.4 million for the quarter ended September 30, 2017. Net chargeoffs in the third quarter of 2018 were \$707 thousand, compared to net chargeoffs of \$820 thousand in the third quarter of 2017. CNB Bank net chargeoffs totaled \$297 thousand and \$334 thousand during the quarters ended September 30, 2018 and 2017, respectively, or 0.05% and 0.06%, respectively, of average CNB Bank loans. Holiday Financial Services Corporation is the Corporation's consumer discount company and recorded net chargeoffs totaling \$410 thousand and \$486 thousand during the quarters ended September 30, 2018 and 2017, respectively. Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2018.

### NON-INTEREST INCOME

Net realized and unrealized gains on trading securities were \$421 thousand during the quarter ended September 30, 2018, compared to \$160 thousand during the quarter ended September 30, 2017. Excluding the effects of securities transactions, non-interest income was \$5.5 million for the quarter ended September 30, 2018, compared to \$4.9 million for the quarter ended September 30, 2017.

As a result of the Corporation's continued focus on growing its Private Client Solutions division, wealth and asset management revenues were \$1.0 million during the quarter ended September 30, 2018, an increase of 8.3% from \$952 thousand during the quarter ended September 30, 2017. In addition, as a result of its organic deposit growth, the Corporation experienced an increase in service charges in deposit accounts of 27.3% in the third quarter of 2018 compared to the third quarter of 2017. Similarly, other service charges and fees increased \$145 thousand, or 24.7%, in the third quarter of 2018 compared to the the third quarter of 2017. Income from investments in Small Business Investment Companies was \$253 thousand in the third quarter of 2018 compared to \$0 thousand in the third quarter of 2017, which is reported as a component of other non-interest income.

### NON-INTEREST EXPENSES

Total non-interest expenses were \$20.8 million and \$17.6 million during the quarters ended September 30, 2018 and 2017, respectively. Salaries and benefits expense increased \$2.3 million, or 25.6%, during the quarter ended September 30, 2018 compared to the quarter ended September 30, 2017. As of September 30, 2018, the Corporation had 534 full-time equivalent staff, compared to 490 full-time equivalent staff as of September 30, 2017, an increase of 9.0%. The remainder of the increase in non-interest expenses is primarily a result of the Corporation's continued growth and the servicing of a larger customer base. Total households serviced at September 30, 2018 were 63,619, compared to 59,026 households at September 30, 2017, an increase of 7.8%.



**INCOME TAX EXPENSE**

As a result of the enactment of the Tax Cuts and Jobs Act in the fourth quarter of 2017, income tax expense decreased \$599 thousand, or 26.2%, during the quarter ended September 30, 2018 compared to the quarter ended September 30, 2017. The Corporation's effective tax rate was 15.4% in the third quarter of 2018 compared to 24.0% in the third quarter of 2017.

The effective rates for the periods differed from the federal statutory rate of 21.0% at September 30, 2018 and 35.0% at September 30, 2017 principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

CONSOLIDATED YIELD COMPARISONS  
AVERAGE BALANCES AND NET INTEREST MARGIN FOR THE NINE MONTHS ENDED  
Dollars in thousands

|   | September 30, 2018 |             |                    | September 30, 2017 |             |                    |
|---|--------------------|-------------|--------------------|--------------------|-------------|--------------------|
|   | Average Balance    | Annual Rate | Interest Inc./Exp. | Average Balance    | Annual Rate | Interest Inc./Exp. |
| <b>ASSETS:</b>                                    |                    |             |                    |                    |             |                    |
| <b>Securities:</b>                                |                    |             |                    |                    |             |                    |
| Taxable (1)                                       | \$349,464          | 2.58 %      | \$6,862            | \$328,947          | 2.56 %      | \$6,286            |
| Tax-Exempt (1,2)                                  | 98,243             | 3.42 %      | 2,507              | 112,581            | 4.12 %      | 3,415              |
| Equity Securities (1,2)                           | 29,755             | 4.10 %      | 915                | 25,988             | 3.64 %      | 710                |
| Total securities                                  | 477,462            | 2.84 %      | 10,284             | 467,516            | 2.99 %      | 10,411             |
| <b>Loans:</b>                                     |                    |             |                    |                    |             |                    |
| Commercial (2)                                    | 795,383            | 4.86 %      | 28,964             | 624,835            | 4.94 %      | 23,132             |
| Mortgage (2)                                      | 1,407,672          | 4.86 %      | 51,034             | 1,287,359          | 4.49 %      | 43,317             |
| Consumer  | 85,088             | 9.95 %      | 6,350              | 80,212             | 9.44 %      | 5,682              |
| Total loans (3)                                   | 2,288,143          | 5.03 %      | 86,348             | 1,992,406          | 4.83 %      | 72,131             |
| Total earning assets                              | 2,765,605          | 4.65 %      | 96,632             | 2,459,922          | 4.48 %      | 82,542             |
| <b>Non interest-bearing assets:</b>               |                    |             |                    |                    |             |                    |
| Cash and due from banks                           | 34,177             |             |                    | 28,282             |             |                    |
| Premises and equipment                            | 49,978             |             |                    | 50,287             |             |                    |
| Other assets                                      | 124,446            |             |                    | 136,815            |             |                    |
| Allowance for loan losses                         | (21,306 )          |             |                    | (17,086 )          |             |                    |
| Total non interest-bearing assets                 | 187,295            |             |                    | 198,298            |             |                    |
| <b>TOTAL ASSETS</b>                               | <b>\$2,952,900</b> |             |                    | <b>\$2,658,220</b> |             |                    |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>      |                    |             |                    |                    |             |                    |
| Demand—interest-bearing                           | \$583,031          | 0.36 %      | \$1,596            | \$550,619          | 0.35 %      | \$1,449            |
| Savings   | 1,028,791          | 0.75 %      | 5,778              | 962,488            | 0.48 %      | 3,454              |
| Time  | 377,774            | 1.43 %      | 4,049              | 231,305            | 1.04 %      | 1,806              |
| Total interest-bearing deposits                   | 1,989,596          | 0.77 %      | 11,423             | 1,744,412          | 0.51 %      | 6,709              |
| Short-term borrowings                             | 46,238             | 1.69 %      | 586                | 137,991            | 1.05 %      | 1,082              |
| Long-term borrowings                              | 250,166            | 2.05 %      | 3,840              | 143,797            | 1.61 %      | 1,737              |
| Subordinated debentures                           | 70,620             | 5.42 %      | 2,873              | 70,620             | 5.55 %      | 2,940              |
| Total interest-bearing liabilities                | 2,356,620          | 1.06 %      | \$18,722           | 2,096,820          | 0.79 %      | \$12,468           |
| Demand—non interest-bearing                       | 319,003            |             |                    | 296,517            |             |                    |
| Other liabilities                                 | 28,633             |             |                    | 27,943             |             |                    |
| Total liabilities                                 | 2,704,256          |             |                    | 2,421,280          |             |                    |
| Shareholders' equity                              | 248,644            |             |                    | 236,940            |             |                    |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$2,952,900</b> |             |                    | <b>\$2,658,220</b> |             |                    |
| Interest income/Earning assets                    |                    | 4.65 %      | \$96,632           |                    | 4.48 %      | \$82,542           |
| Interest expense/Interest-bearing liabilities     |                    | 1.06 %      | 18,722             |                    | 0.79 %      | 12,468             |
| Net interest spread                               |                    | 3.59 %      | \$77,910           |                    | 3.69 %      | \$70,074           |
| Interest income/Earning assets                    |                    | 4.65 %      | 96,632             |                    | 4.48 %      | 82,542             |
| Interest expense/Earning assets                   |                    | 0.90 %      | 18,722             |                    | 0.68 %      | 12,468             |
| Net interest margin                               |                    | 3.75 %      | \$77,910           |                    | 3.80 %      | \$70,074           |

(1)

Includes unamortized discounts and premiums. Average balance is computed using the carrying value of securities. The average yield has been computed using the historical amortized cost average balance for available for sale securities.

(2) Average yields are stated on a fully taxable equivalent basis.

Average outstanding includes the average balance outstanding of all non-accrual loans. Loans consist of the

(3) average of total loans less average unearned income. The amount of loan fees included in the interest income on loans is not material.

## RESULTS OF OPERATIONS

Nine Months Ended September 30, 2018 and 2017

### OVERVIEW OF THE INCOME STATEMENT

The Corporation had net income of \$24.8 million for the nine months ended September 30, 2018 and \$20.4 million for the same period in 2017. The earnings per diluted share were \$1.62 for the nine months ended September 30, 2018 and \$1.34 for the nine months ended September 30, 2017. The annualized return on assets and return on equity for the nine months ended September 30, 2018 are 1.12% and 13.28% compared to 1.02% and 11.48% for the same period in 2017.

### INTEREST INCOME AND EXPENSE

Net interest margin on a fully tax equivalent basis was 3.75% and 3.80% for the nine months ended September 30, 2018 and 2017, respectively. The yield on earning assets increased 17 basis points to 4.65% for the nine months ended September 30, 2018 from 4.48% for the nine months ended September 30, 2017. The cost of interest-bearing liabilities increased 27 basis points to 1.06% for the nine months ended September 30, 2018 from 0.79% for the nine months ended September 30, 2017.

Total interest and dividend income increased by 19.1% to \$95.5 million for the nine months ended September 30, 2018 from \$80.2 million for the nine months ended September 30, 2017. Net interest income increased by 13.4% to \$76.8 million for the nine months ended September 30, 2018 from \$67.7 million for the nine months ended September 30, 2017.

### PROVISION FOR LOAN LOSSES

During the nine months ended September 30, 2018, the Corporation recorded a provision for loan losses of \$4.6 million, as compared to a provision for loan losses of \$3.6 million for the nine months ended September 30, 2017. Net chargeoffs for the nine months ended September 30, 2018 were \$1.8 million, compared to net chargeoffs of \$2.0 million for the nine months ended September 30, 2017. CNB Bank net chargeoffs totaled \$436 thousand and \$392 thousand during the the nine months ended September 30, 2018 and 2017, respectively, or 0.02% and 0.02%, respectively, of average CNB Bank loans. Holiday is the Corporation's consumer discount company and recorded net chargeoffs totaling \$1.4 million and \$1.6 million during the nine months ended September 30, 2018 and 2017, respectively.

Management believes the provision for loan losses was appropriate and the allowance for loan losses is adequate to absorb probable incurred losses in our portfolio as of September 30, 2018.

### NON-INTEREST INCOME

Net realized gains on available-for-sale securities were \$0 during the nine months ended September 30, 2018, compared to \$1.5 million during the nine months ended September 30, 2017. Net realized and unrealized gains on trading securities were \$672 thousand during the nine months ended September 30, 2018, compared to \$475 thousand during the nine months ended September 30, 2017. In addition, the Corporation realized a gain on the sale of a branch in the second quarter of 2017 of \$536 thousand. Excluding the effects of securities transactions and the gain on sale of a branch, non-interest income was \$15.6 million for the nine months ended September 30, 2018, compared to \$13.3 million for the nine months ended September 30, 2017.

As a result of the Corporation's continued focus on growing its Private Client Solutions division, wealth and asset management revenues were \$3.2 million during the nine months ended September 30, 2018, an increase of 13.5% from \$2.8 million during the nine months ended September 30, 2017. In addition, as a result of its organic deposit growth, the Corporation experienced an increase in service charges in deposit accounts of 17.2% in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. Similarly, other service charges and fees increased \$398 thousand, or 23.8%, in the first nine months of 2018 compared to first nine months of 2017. Net income (loss) attributable to investments in Small Business Investment Companies was \$558 thousand in the nine months ended September 30, 2018 compared to \$(37) thousand in the nine months ended September 30, 2017, which is reported as a component of other non-interest income.





#### NON-INTEREST EXPENSES

Total non-interest expenses were \$59.3 million and \$52.4 million during the nine months ended September 30, 2018 and 2017, respectively. Salaries and benefits expense increased \$4.1 million, or 15.1%, during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. As of September 30, 2018, the Corporation had 534 full-time equivalent staff, compared to 490 full-time equivalent staff as of September 30, 2017, an increase of 9.0%. The remainder of the increase in non-interest expenses is primarily a result of the Corporation's continued growth. Total households serviced at September 30, 2018 were 63,619, compared to 59,026 households at September 30, 2017, an increase of 7.8%.

The ratio of non-interest expenses to average assets was 2.68% and 2.63% during the nine months ended September 30, 2018 and 2017, respectively.

#### INCOME TAX EXPENSE

As a result of the enactment of the Tax Cuts and Jobs Act in the fourth quarter of 2017, income tax expense decreased \$2.8 million, or 39.5%, during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. The Corporation's effective tax rate was 14.9% in the nine months ended September 30, 2018 compared to 26.1% in the nine months ended September 30, 2017.

The effective rates for the periods differed from the federal statutory rate of 21.0% at September 30, 2018 and 35.0% at September 30, 2017 principally as a result of tax exempt income from securities and loans as well as earnings from bank owned life insurance.

#### CRITICAL ACCOUNTING POLICIES

The Corporation's accounting and reporting policies are in accordance with GAAP and conform to general practices within the financial services industry. Accounting and reporting practices for the allowance for loan losses and fair value of securities are deemed critical since they involve the use of estimates and require significant management judgments. In addition, the fair value of assets acquired and liabilities assumed in connection with business combinations, including the associated goodwill that was recorded, required the use of material estimates. Application of assumptions different than those used by management could result in material changes in the Corporation's financial position or results of operations. Note 1 (Summary of Significant Accounting Policies), Note 2 (Business Combination and Branch Sale), Note 4 (Securities), and Note 5 (Loans) of the Corporation's 2017 Form 10-K, provide detail with regard to the Corporation's accounting for the allowance for loan losses, the fair value of securities, business combinations and loans. There have been no significant changes in the application of accounting policies since December 31, 2017.

## ITEM 3

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a financial institution, the Corporation's primary source of market risk is interest rate risk, which is the exposure to fluctuations in the Corporation's future earnings resulting from changes in interest rates. This exposure is correlated to the repricing characteristics of the Corporation's portfolio of assets and liabilities. Each asset or liability reprices either at maturity or during the life of the instrument.

The principal purpose of asset/liability management is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Net interest income is enhanced by increasing the net interest margin and by the growth in earning assets. As a result, the primary goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation uses an asset-liability management model to measure the effect of interest rate changes on its net interest income. The Corporation's management also reviews asset-liability maturity gap and repricing analyses regularly. The Corporation does not always attempt to achieve a precise match between interest sensitive assets and liabilities because it believes that an actively managed amount of interest rate risk is inherent and appropriate in the management of the Corporation's profitability.

Asset-liability modeling techniques and simulation involve assumptions and estimates that inherently cannot be measured with precision. Key assumptions in these analyses include maturity and repricing characteristics of assets and liabilities, prepayments on amortizing assets, non-maturing deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude, and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

Management reviews interest rate risk on a quarterly basis and reports to the ALCO. This review includes earnings shock scenarios whereby interest rates are immediately increased and decreased by 100, 200, 300, and 400 basis points. These scenarios, detailed in the table below, indicate that there would not be a significant variance in net interest income over a one-year period due to interest rate changes; however, actual results could vary significantly. Based on the most recent data available as of September 30, 2018, all interest rate risk levels according to the model were within the tolerance limits of ALCO approved policy. In addition, the table does not take into consideration changes that management would make to realign its assets and liabilities in the event of an unexpected change in the interest rate environment. Due to the current interest rate environment, the -300 and -400 scenarios have been excluded from the table.

September 30, 2018

| Change in<br>Basis Points | % Change in Net<br>Interest Income |
|---------------------------|------------------------------------|
| 400                       | 9.5%                               |
| 300                       | 7.8%                               |
| 200                       | 6.5%                               |
| 100                       | 6.5%                               |
| (100)                     | (0.9)%                             |
| (200)                     | (2.7)%                             |

ITEM 4

CONTROLS AND PROCEDURES

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of the Corporation's management, including the Chief Executive Officer and Principal Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934) ("Exchange Act"). Based on their evaluation, our Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the period covered by this quarterly report to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. There were no changes in the Corporation's internal control over financial reporting that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## PART II OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS – None

ITEM 1A. RISK FACTORS – There have been no material changes to the risk factors disclosed in Part I, Item IA of the 2017 Form 10-K.

## ITEM 2. ISSUER PURCHASES OF EQUITY SECURITIES

The following table provides information with respect to any purchase of shares of the Corporation's common stock made by or on behalf of the Corporation for the three months ended September 30, 2018.

| Period                 | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or approximate dollar value) of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|------------------------|----------------------------------|------------------------------|--|--|
| July 1 - 31, 2018      | —                                | \$                           | —  | 369,860  |
| August 1 - 31, 2018    | —                                | —                            | —  | 369,860  |
| September 1 - 30, 2018 | —                                | —                            | —  | 369,860  |

The Corporation's stock repurchase program, which was announced on November 12, 2014, authorizes the repurchase of up to 500,000 shares of common stock. The program will remain in effect until fully utilized or until modified, suspended or terminated. As of September 30, 2018, there were 369,860 shares remaining in the program.

ITEM 6. EXHIBITS

| Exhibit No. | Description   |
|-------------|---|
| 3.1         | <u>Amended and Restated Articles of Incorporation of the Corporation, filed as Appendix B to the 2006 Proxy Statement, filed with the SEC on March 24, 2006, and incorporated herein by reference.</u>    |
| 3.2         | <u>By-Laws of the Corporation, as amended and restated, filed with the SEC as Exhibit 3.1 to the Corporation's current report on Form 8-K filed April 24, 2017, and incorporated herein by reference.</u> |
| 31.1        | <u>Rule 13a – 14(a)/15d – 14(a) Certification of the Principal Executive Officer</u>  |
| 31.2        | <u>Rule 13a – 14(a)/15d – 14(a) Certification of the Principal Financial Officer</u>  |
| 32.1        | <u>Section 1350 Certification</u>   |
| 32.2        | <u>Section 1350 Certification</u>   |
| 101.INS     | XBRL Instance Document  |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF     | XBRL Taxonomy Extension Definitions Linkbase Document   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document  |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CNB FINANCIAL CORPORATION  
(Registrant)

DATE: November 8, 2018    /s/ Joseph B. Bower, Jr.  
Joseph B. Bower, Jr.  
President and Director  
(Principal Executive Officer)

DATE: November 8, 2018    /s/ Brian W. Wingard  
Brian W. Wingard  
Treasurer  
(Principal Financial Officer)